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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946.

No.....

CITIES SERVICE GAS COMPANY, a corporation,
PETITIONER,

vs.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; the CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; and CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, RESPONDENTS.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

Cities Service Gas Company, petitioner herein (referred to as "Company" or "petitioner"), respectfully prays that this Court issue its writ of certiorari to review the final judgment of the United States Circuit Court of Appeals for the Tenth Circuit (referred to as "Court of Appeals") *(R.V. 3, p. 1349)* affirming a final order of the Federal Power Commission (referred to as "Commission") under the "Natural Gas Act" of 1938, which order found that "the rates and charges made, demanded or received by the Company for and in connection with its transportation and sale of natural gas in interstate commerce for resale for ultimate

public consumption are unjust, unreasonable and excessive by at least $5,499,665 based upon the Company's operations during the test year 1941" *(R. V. 1, p. 69)*.[1] The Commission thereupon directed that "the rates and charges * * * be so reduced as to reflect * * * a reduction of not less than $4,445,871 ($5,499,665 less $1,053,794) below its 1941 operating revenues * * *" *(R. V. 1, pp. 69-70)*. Application for rehearing was made and denied *(R. V. 1, pp. 70-71)*.

OPINIONS BELOW.

The opinion of the Court of Appeals, Judge Phillips dissenting *(R. V. 3, pp. 1323-1349)*, in case entitled *Cities Service Gas Company v. Federal Power Commission, et al.*, is reported in 155 Fed. (2d) 694. The opinion and order of the Commission *(R. V. 1, pp. 28-70)* is reported in 50 P.U.R. (n.s) 65.

JURISDICTION.

The judgment of the Court of Appeals was entered April 30, 1946 *(R. V. 3, pp. 1349-1350)*. Petition for rehearing, filed herein on July 1, 1946 *(R. V. 3, pp. 1351-1392)*, was overruled July 5, 1946 *(R. V. 3, p. 1393)*. To such petition for rehearing and supporting memorandum brief the consideration of this Court respectfully is invited *(R. V. 3, pp. 1351-1392)*.

The jurisdiction of this Court is invoked under *Section 347 (a) (Section 240, amended) of the Judicial Code (U.S. C.A., Title 28, Section 347(a)) and Section 19(b) of the Natural Gas Act (52 Stat. 821; 15 U.S.C.A., Sec. 717 r (b))*.

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[1]The Commission further found:

"Due, however, to the necessity for relieving the gas transportation shortage in the Mid-Continent area, and in order to expedite the construction of a proposed 26-inch main transmission pipe line to the Hugoton Gas Field and other facilities required to produce and transport gas from such field, it is in the public interest, for the purpose of this interim order, to make an additional allowance of $1,053,794 in the cost of service for the Company's gas sales subject to the Commission's jurisdiction;

"The natural gas rates and charges of the Company subject to the Commission's jurisdiction should be reduced by not less than $4,445,871, as hereinafter provided;"

STATUTE INVOLVED.

The statute involved is the Natural Gas Act *(52 Stat. 821; 15 U.S.C.A., Sec. 717)*, the pertinent provisions of which are set forth in *Appendix A, infra.*

QUESTIONS PRESENTED.

For clarity, it is necessary that each of the "Questions Presented" be preceded by a statement of the particular issue of law and fact involved, based upon the record herein.

1.

Administrative "Jurisdiction of the Commission and Scope of Review."

(1) The Court of Appeals, Judge Phillips dissenting, under the foregoing subject caption and elsewhere throughout its opinion herein, indulged and acted upon its assumption that the reviewing court is without authority of law to perform any real function of "limited" judicial review as contemplated and provided by *Section 19(b)* of the Gas Act[2] *(R. V. 3, pp. 1327, 1327-1328, 1339)*. Accordingly, the review in this case, under the announced concept of the Court of Appeals as to the meaning of *Section 19(b)* of the Gas Act,

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[2]Section 19 of the Gas Act provides in substance:

The provision for rehearing before the Commission provides that such application "shall set forth *specifically* the ground or grounds upon which such application is based," not merely a general objection that the finding of "unreasonableness" is "arbitrary." Thus the Commission is given opportunity to correct its errors, on the assumed concept that "true wisdom always is discreet, and not ashamed of wise retreat."

The judicial review before the Court of Appeals, predicated *solely* upon the "transcript of the record" before the Commission, provides: "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing * * *," which means that all such objections so urged shall be considered by the reviewing Court; "The finding of the Commission as to the *facts, if supported by substantial evidence*, shall be conclusive," or conversely, if not supported by "substantial evidence," cannot stand; and "The judgment and decree of the Court, affirming, modifying or setting aside, *in whole or in part*, any such order of the Commision, shall be final * * *." Herein in *plain language*, the statute provides that usual and ample statutory review of orders of administrative agencies, developed and established by long legislative and judicial practice and the undoubted applicable law of the land at the time of the passage of the Natural Gas Act.

and in general reliance upon certain opinions and decisions of this Court, became merely a glorified formality of approbation and approval.[3]

The question presented then is: Whether the Court of Appeals, in so construing and applying *Section 19(b)* of the Gas Act, has proceeded in conformity with the correct rule of law.

(2) The Court of Appeals, throughout the majority opin-

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[3]The Court of Appeals did not undertake to define and declare its own functions and duties as the Court of review, but by its repeated assertions and conclusions as to the finality of the administrative process disclosed a philosophy wholly at variance with any real or effective judicial supervision and review whatever. It declared, among other things:

"It is of first importance to take account of the respective provinces assigned to the Commission and the Courts on review in order that we may perform the functions assigned to us *without trespass upon the administrative prerogatives*" (*R.V. 3, p. 1327*).

"In delineating the scope of review, the Courts have left no doubt of their disposition to give the Commission a *free rein* in the effectuation of the Congressional purpose. The *administrative process is no longer fettered by judicial notions of the 'economic merits' of the rate order.*" (*R.V. 3, p. 1327*).

"It hardly seems necessary nor appropriate to reiterate what has already been so emphatically said concerning the '*broad area of discretion*' committed to the Commission * * *" (*R.V. 3, p. 1327*).

"It is said that a *finding of reasonableness* made after a full hearing by the Commission is the product of 'expert judgment,' which carries with it a strong presumption that it meets the statutory requirements" (*R.V. 3, p. 1328*).

These postulates the Court of Appeals applied, as follows:

"And since the constitutional requirements are no more exacting than the statutory standards of the Act, there is an *almost conclusive presumption* that the order which meets the statutory standards does not exceed the bounds of due process" (*R.V. 3, p. 1328*).

"But if, under the prevailing view, the economic merits of a rate base is of no judicial concern, * * *, we have not the right to intercede *unless it is conclusively shown that failure to give consideration to the fair value of properties, including the valuable leasehold estates, will prevent the company from operating successfully as a public utility*" (*R.V. 3, p. 1332*).

"*If some of the specific allocations appear to be illogical and unfair, they necessarily pose technological problems of accounting and finance upon which the administrative judgment has been declared virtually supreme. We shall not criticize that which we are powerless to correct*" (*R.V. 3, p. 1339*).

"If allocation of cost of service is a fundamentally correct and permissible method of effecting a separation of the regulable from the non-regulable sales, *we cannot say* on this record *that the application of the formula is so wholly unrelated to the facts* as to produce an illegal or reversible result" (*R.V. 3, p. 1339*).

ion herein, repeatedly and progressively asserted and declared that the Commission action and order under review is attended with "an almost conclusive presumption," with "a free rein," with a non-reviewable "area of discretion," and with such a weight and number of presumptions and assumptions that the reviewing court is "powerless" to examine, to correct, or to "criticize" Commission action, even though it be "illogical and unfair," that is, arbitrary or capricious *(R. V. 3, pp. 1327-1328, 1335, 1336, 1337, 1339)*.

The question presented then is: Whether, on review, Commission findings are "virtually supreme" and non-reviewable *(R. V. 3, p. 1339)* unless "it is conclusively shown" by the petitioner that the Commission action "will prevent the company from operating successfully as a public utility" *(R. V. 3, p. 1332)*, or unless the Commission conclusion is "wholly unrelated to the facts" *(R. V. 3, p. 1339)*, "the statutory standard of 'fair and reasonable' ", *Section 19(b)* of the Gas Act and other law of the land to the contrary notwithstanding.

(3) The Court of Appeals, speaking through Judge Murrah, by its assertions that Commission action for various assigned reasons is "virtually supreme" *(R. V. 3, pp. 1328, 1332, 1339)* and is attended by presumptions that dispense with the requirements of basic proof *(R. V. 3, pp. 1333, 1335, 1336, 1337)*, declared, in effect, that if the reviewing court actually undertakes to review the record to determine whether the Commission addressed itself to the evidence, whether its findings are supported by "substantial evidence" or whether its conclusions are "fair and reasonable" or unfair, illogical, arbitrary or capricious, such judicial procedure would constitute an unlawful "trespass upon the administrative prerogatives."

The questions presented then are:

Whether Commission action in effect is immune from judicial review "as to the facts."

Whether the result of review lawfully may be predetermined by the presumptions, assumption and rules of law as announced by the Court of Appeals herein before the judicial inquiry is launched.

2.

"Regulation of Producing and Gathering of Natural Gas."

The Commission in its opinion and order herein *(R. V. 1, pp. 37, 50)* included all the production properties and gathering facilities of petitioner "in the rate base" and similarly and directly included, as subject to its rate-regulatory authority, all operations, revenues, expenses, return and depreciation of such properties and operations as an inherent part of its rate reduction order herein *(R. V. 1, pp. 52, 57-58)*.

This action of the Commission the Court of Appeals, Judge Phillips dissenting, approved on the ground that such jurisdiction had been "squarely met and conclusively decided" in favor of the Commission assertion of such authority *(Canadian River Gas Co. v. Federal Power Commission,* 324 U.S. 581, 65 S. Ct. 829). In that case *a minority only of this Court* (Justices Douglas, Black, Murphy and Rutledge) declared that despite the specific exclusion by the terms of *Section 1(b)* of the Gas Act, nevertheless the Commission possessed rate-regulatory authority over "the production or gathering of natural gas," save and except "the Commission has no control over the drilling and spacing of wells and the like. It may put other limitations on the Commission." Thus the meaning and scope of the statutory language in question, which is directly involved in this case, has been clouded and not been settled as yet by any "authoritative precedent" of this Court, which to be authoritative must be participated in by not less than five Justices concurring on "the principles of law involved" *(United States v. Pink,* 315 U.S. 203, 62 S. Ct. 552, opinion by Mr. Justice Douglas).

The question presented then is: Whether the provisions of the Gas Act shall apply to the production or gathering of natural gas, contrary to the express and specific prohibition of *Section 1(b)* of the Act.

3.

Rate Base of Natural Gas Reserves.

The Commission herein *(R. V. 1, pp. 31-32)* assumed as a matter of law in reliance upon its own decisions in *Detroit v. Panhandle Eastern Pipe Line Company,* 45 P.U.R. (n.s.) 203, 208-210, and *Re Chicago District Electric Generating Company,* 39 P.U.R. (n.s.) 263, 269-272, and as "an inexorable rule" that it was required by *Section 6(a)* of the Gas Act to predicate its rate base, including gas reserves and leaseholds, for the purpose of its inquiry into "the reasonableness of rates and charges" solely upon "actual legitimate cost," so-called, if, as was found to be the fact in this case, such "cost" is "accurately ascertainable from the books and records" *(R. V. 1, p. 32; R. V. 3, p. 1330).* The actual fair value of the reserves and leaseholds the Commission held to be "immaterial and irrelevant" *(R. V. 3, p. 1331).*

This Court has declared repeatedly to the contrary that, in the determination and fixation of a rate base, "the Commission was not bound to the use of any single formula or combination of formulas in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' When the Commission's order is challenged in the Courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Under the statutory standard of 'just and reasonable,' it is the result reached, not the method employed, which is controlling" *(Federal Power Commission vs. Hope Natural Gas Company,* 320 U.S. 591, 64 S. Ct. 281).

The Court of Appeals, Judge Phillips dissenting, ignored completely the "erroneous view of the law" adopted by the Commission, as well as the controlling principles declared by this Court, and sought to justify the Commission order by the quotation of part of a statement made by Mr. Justice Douglas in the *Canadian* case *(324 U.S. 581, 604, 65 S. Ct. 829, 841), supra,* where it is said: "Hence we cannot say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost" *(R. V. 3, pp. 1332-1333).* The Court of Appeals, how-

ever, did not refer to or quote the remainder of the same statement of Mr. Justice Douglas, which was: "That could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case." Obviously the entire statement of Mr. Justice Douglas does not carry the meaning attributed to it by the Court of Appeals in its partial quote therefrom. Thus, neither the Commission nor the Court of Appeals "proceeded under a correct rule of law."

The "end result" is that vast gas reserves, admittedly of very great actual value, were included in the Commission rate base at nominal amounts or at zero dollars *(Op. of Ct., R. V. 3, pp. 1329-1333. See Dissent. Op., R. V. 3, pp. 1342-1346).*[4]

The Commission, under its self-imposed rigid "cost" rule, precluded itself from any consideration of "pragmatic adjustments which may be called for by particular circumstances" or of "the statutory standard of 'just and reasonable' "; and the Court of Appeals bluntly refused *(R. V. 3, pp. 1332-1333)* to enter into any process of review whatever or even to examine into or determine whether "the Commission's order, as applied to the facts before it and viewed in its entirety, produces an arbitrary result," which is its judicial function and duty *(Federal Power Commission v. Natural Gas Pipeline Co.,* 315 U.S. 575, 586, 62 S. Ct. 736, 743).

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[4]This Court as yet has not considered in any case the "end result" of an order of rate reduction where as here the natural gas leaseholds and reserves were included in the rate base at Commission "cost."

In the *Hope Natural Gas Company* case, *supra,* as pointed out by Judge Phillips (*R.V. 3, p. 1347*), the issue of fair value of gas reserves was not involved, and "the Company on the other hand has not put its gas fields into its calculations on the present value basis * * *" (*320 U.S. 596, 645, 64 S. Ct. 281, 308*).

In the *Natural Gas Pipeline Company* case, *supra,* the natural gas reserves were reflected in the rate base at "fair value" (*315 U. S. 575, 580, 586, 62 S. Ct. 736, 740, 743*).

In the *Panhandle Eastern Pipe Line Company* case, *supra,* (*324 U. S. 635, 638, 65 S. Ct. 821,823*) as in the *Canadian River Gas Company* case, *supra,* (*324 U. S. 581, 605-6, 65 S. Ct. 829, 841*) the review in this Court was limited and did not embrace the question of "end result" of the ordered rate reduction, based upon a Commission "cost" rate base.

The questions presented then are:

Whether the Commission in its determination of rate base lawfully may refuse to consider or receive in evidence, as a matter of law, any and all evidence of the fair and actual value of gas reserves and producing properties, on the premise that it is required by *Section 6(a)* of the Gas Act to consider "cost" and cost alone when such cost is "accurately ascertainable."

Whether the Court of Appeals, as the reviewing court, may abdicate its functions of review under *Section 19(b)* of the Gas Act, or lawfully may evade and refuse to pass on and decide the propriety of such Commission action (1) under the erroneous view of the law entertained by that body, (2) as measured by "the statutory standard of 'just and reasonable,'" and (3) whether "The Commission's order, as applied to the facts before it and viewed in its entirety, produces an arbitrary result."

Whether evidence of fair value of gas reserves and production properties must be received in evidence in connection with the Commission determination of rate base to enable that body: to make an informed determination of the proper and fair formula or combination of formulas which should be used in the particular case; "to make the pragmatic adjustments which may be called for by particular circumstances"; to insure that its order "as applied to the facts before it and viewed in its entirety produces no arbitrary result"; and to permit the reviewing Court, as is its duty, to examine and decide, on the record in the case and not at large, whether the Commission has confined itself to the facts before it or has otherwise abused its "administrative prerogatives" by indulging in unreasonable, unfair, arbitrary or illegal action.

4.

"Existing Depreciation and Depletion."

The Commission made the following finding:

"The Commission's staff presented a complete depreciation and depletion reserve requirement study, i.e., a computation of the reserves which should have been ac-

crued had the Company properly recorded in reserves the accumulated cost of the property consumed in service. *A qualified staff engineer inspected the Company's properties,* analyzed its past experience and that of its predecessors, and estimated the overall service lives of the property by classes. *He considered* service life data on other pipe lines, and *treated realistically both the physical and functional aspects of depreciation."* (Emphasis added.)

(R. V. 1, p. 44.)

The vital *(R. V. 1, pp. 428, 430)* portion of the foregoing finding, "A qualified staff engineer inspected the Company's properties," is without support in and contrary to the record. The "staff engineer" referred to admitted directly and specifically on cross-examination that not a single actual field inspection was made by the Commission of any part of the pipeline system of petitioner *(R. V. 1, pp. 450-451, Op. of Ct., R. V. 3, pp. 1334-1335),* which system of more than 4300 miles of pipeline constitutes more than 70% of the Commission total "actual legitimate cost" rate base adopted in this case *(Comm. Ex. 5, pp. 977-978; R. V. 1, p. 50).* The purpose of "the field inspections," also referred to as "field examination," the witness testified in detail was "to observe" and ascertain the actual physical condition and "existing depreciation" of the property *(R. V. 1, pp. 428, 430).* As summarized by the Court of Appeals, "He did make a field inspection of the Company's properties for the purpose of observing physical deterioration * * * and other conditions which would affect his judgment of the service life of the property" *(R. V. 3, p. 1334).*

The Court of Appeals, fully aware of the failure of the evidence to support the basic Commission finding in question *(R. V. 3, pp. 1334-1335),* made a finding of its own excusing the "staff engineer" for not making the "inspections" in question. The Commission made no such finding. The finding of the Court, of course, was in substitution for the discredited Commission finding and to justify and support on other grounds the Commission conclusions *(R. V. 3, pp. 1334-1335),* which rested on the Commission staff's inspection and studies *(Comm. Ex. 15, R. V. 3, pp. 1127-1142).*

In other respects, later herein considered, the Commission findings on depreciation are without support in and contrary to the evidence *(R. V. 1, pp. 45-46, 207-208)*.

The questions presented then are:

Whether the unsupported findings of the Commission lawfully can be permitted to support or contribute to the support of the Commission conclusions as to "existing depreciation."

Whether the Court of Appeals is "authorized under *Section 19(b)* to make findings and substitute them for those of the Commission."

5.

Natural Gasoline Operations of Cities Service Oil Company.

The record discloses without contradiction that certain of the natural gas produced or purchased by petitioner, Cities Service *Gas* Company, is, under contract, treated in the natural gasoline extraction plants of Cities Service *Oil* Company (situated as much as 250 miles from field points of production, *R. V. 3, p. 1125, Map)*, an affiliate company which is not a "natural gas company" under the Gas Act. This petitioner admittedly never has had any title or interest whatever in any of said plants or in their operation. The Commission nevertheless segregated the natural gas extraction plants of the *Oil* Company from the other properties of the *Oil* Company and treated such plants and the operation thereof "as if they belonged to petitioner" *(Op. of Ct., R. V. 3, pp. 1335-1337; R. V. 1, pp. 53-55; R. V. 2, pp. 792, 802)*. See dissenting opinion, Judge Phillips *(R. V. 3, pp. 1347-1349)*. The Commission thereupon embarked on a rate case. It set up a "cost" rate base (after "some inspection," *R. V. 2, pp. 771-773)* covering the gasoline extraction plants in question and allowed the *Oil* Company 6½% return on such rate base depreciated, but made no allowance whatever to the *Oil* Company for Federal income taxes *(R. V. 2, pp. 805, 806; R. V. 3, p. 1021)*. All other earnings (upon natural gas sold both under regulable sales and under non-regulable sales), averaged over a four-year period at $380,000 a year and described as "average annual excess profits," resulting

from the gasoline extraction operations, were not added to operating revenues but were credited by the Commission to "the operating expenses" of this petitioner *(R. V. 1, p. 56)*.[5]

The Court of Appeals sustained the Commission action on the *factual assumption* that "the extraction process was *a necessary function* of the business of transporting and delivering natural gas to market by means of a pipeline system and that such process was *essential* to the transportation and sale of natural gas" *(R. V. 3, p. 1336)*. *The Commission made no such finding*, and on the record could not have made such a finding. It found generally that "This operation is profitable and *renders the natural gas more readily marketable and transportable" (R. V. 1, p. 53)*. But, even this mild finding is not supported by and is contrary to the record herein *(R. V. 2, pp. 775, 776; Ex. 14, p. 1125)*.

Neither the Commission *(R. V. 2, pp. 792, 802)* nor the Court of Appeals *(R. V. 3, p. 1336)* noticed or respected the salutary and controlling principle of law that the *Oil* Company "is to be treated as a segregated enterprise" even though the affiliate relation "may demand close scrutiny" *(Smith v. Illinois Bell Telephone Co.*, 282 U.S. 144, 151-153, 51 S. Ct. 65, 67, 70).

The questions presented then are:

Whether the Commission lawfully may exercise rate-regulatory authority over the separate and independent natural gasoline extraction plants of Cities Service *Oil* Company and the operation thereof, precisely the same "as if they (such plants and operations) belonged to petitioner," Cities Service *Gas* Company.

Whether the Court of Appeals may, in the discharge of its judicial functions under *Section 19(b)* of the Gas Act, (1) disregard as immaterial and irrelevant the principle of law that, while the reasonableness of dealings between affiliates, if not at arm's length, may be inquired into, each continues

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[5]The effect of this accounting manipulation, upon the Commission's "cost of service" which is the basis of the "cost of service allocation" will be considered under the subject title "Allocation of Cost of Service," *infra*.

to be and must be treated as a separate and segregated enterprise, or (2) make findings and substitute them for those of the Commission.

6.

Federal Income Taxes.

The Commission refused to allow as deductible expense any Federal income tax whatever on the theory that the elimination of "the sum of $1,882,142 (that is: the entire Federal income tax liability of petitioner for the year 1941 on the basis of the Commission's computation *(Comm. Ex. 41, R. V. 3, pp. 1264-5))* represents the reduction in the Company's 1941 Federal income tax which would have resulted if the net utility income (that is, on both jurisdictional and non-jurisdictional business) had not exceeded a 6½% return on the rate base of $48,567,756" (that is, the total Commission "rate base" covering both jurisdictional and non-jurisdictional properties and operations *(R. V. 1, p. 50)) (R. V. 1, p. 57, note, 57-58).*[6]

"The effect of the disallowance was to assign all Federal income tax liability for the year 1941 to non-regulable sales" *(Op. Ct., R. V. 3, p. 1337)* in excess of 6½% return on the Commission overall "rate base." In fact the Commission did not reduce merely, it eliminated entirely, all Federal income taxes from this case *(Comm. Ex. 10, Sch. 4, R. V. 3, p. 1013).*[7]

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[6]The procedure was quite different in *Colorado Interstate Gas Co. v. Federal Power Comm.*, 324 U. S. 581, 587, 65 S. Ct. 829, 832. Federal income taxes there were included in deductible expenses and were reflected in the "cost of service" and in the "cost of service allocation" as stated by Mr. Justice Douglas in that case as follows: "And one-half of the return and income taxes on the Denver pipeline and one-half of operating labor of the compressing system were classed as volumetric, the other half being classed as capacity." Here, on the other hand, *only* "State income taxes" were treated as deductible expense and reflected in the "cost of service" and "cost of service allocation." Such State income taxes then "were allocated 50% to 'commodity' and 50% to 'demand.'" *(R.V. 1, p. 60).*

[7]The amount of Federal income taxes for 1941 eliminated by the Commission under its theory of tax liability was $310,592. There are no Commission findings on the subject *(R.V. 1, p. 57 note).* However, the amount can be arrived at approximately by applying to the staff's method of computation *(Comm. Ex. 41, R.V. 3, pp. 1264-1265)* the amounts of the various items involved as actually incorporated into the Commission opinion and order:

The Court of Appeals obviously was inaccurate, if not confused, for it declared: "The disallowance is based on the thesis that if the rates and charges on the *regulable sales* had not exceeded an amount sufficient to return 6½% on the adopted rate base, the tax liability would not have been incurred, consequently it cannot be allowed as an expense" *(R. V. 3, p. 1337)*. Thus the Commission theory and the Court's concept of that theory are divergent. However, both Commission and Court of Appeals proceeded on *the legal theory* that the Commission has rate-regulatory authority with respect to *all* earnings over 6½% on the Commission overall rate base, whether such earnings be derived from the "regulable sales" for resale or the "non-regulable sales" for direct consumption *(R. V. 1, p. 57, note, 57-58, R. V. 3, p. 1337)*. This is so stated by the Court of Appeals, *referring to earnings on the "non-regulable sales" in excess of 6½% return,* as follows: "The petitioner may not charge as an expense that which it cannot lawfully earn" *(R. V. 3, p. 1337)*. This statement is made, notwithstanding *Section 1(b)* of the Gas Act, *Panhandle Eastern Pipe Line Co. v. Federal Power Comm.*, 324 U.S. 635, 641-642, 65 S. Ct. 821, 825, and *Colorado Interstate Gas Co. v. Federal Power Comm. (Mr. Justice Douglas)*, 324 U.S. 581, 588, 65 S. Ct. 829, 833, which

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Taxable income for 1941 per Federal income tax return filed	$6,057,181.46
Adjustments by staff:	
Processing earnings (Natural gasoline extraction "excess profits"—*R.V. 1, p. 54*)	380,000.00
Price of purchased gas	65,203.76
Adjusted taxable income before applying Revenue Reduction	$6,502,385.22
Revenue Deduction (*R.V. 1, p. 61*)	5,499,665.00
(Note: The Hugoton allowance of $1,053,794 (*R.V. 1, p. 63*) does not enter into this computation for no tax deduction of any kind was reflected therein.)	
	$1,002,720.22

Computation of Tax

Normal tax—24% of $1,002,720	$ 240,652.00
Surtax:	
6% of $25,000	1,500.00
7% of $977,719	68,440.00
	$ 310,592.00

declare in conformity with the statute that it is immaterial what the revenues and earnings from the non-regulable sales may be, since the authority to regulate these phases of the business is lacking.

It is to be noted also that *all* revenues from all sources *(R. V. 1, p. 52)* and *all* expenses and deductions of every sort except Federal income taxes *(R. V. 1, p. 58; R. V. 3, pp. 1191, 1209, 1264)* are reflected in the Commission conclusion as to "Income Available for Return to Company" *(R. V. 1, p. 58)*. The stated amount, after deduction of "Annual Return of 6½% on Rate Base"—that is, 6½% return from both "regulable sales" and "non-regulable sales" upon the Commission *overall* "rate base," embracing both jurisdictional and non-jurisdictional properties and operations, is used as the base described as "cost of service" for the "cost of service allocation," so-called *(R. V. 1, pp. 58, 61)*. Consequently, the item of Federal income taxes is excluded in its entirety as a proper and lawful expense deduction. See dissenting opinion, Judge Phillips *(R. V. 3, p. 1349)*.

Had Federal income taxes been reflected, as in the *Colorado Interstate Gas Company* and *Colorado-Wyoming Gas Company* cases, one-half of the $310,000 of such income taxes, to-wit: $155,000, would have been allocated to the regulable sales and operations and the rate reduction herein would have been $155,000 less than actually was ordered.[8]

The questions presented then are:

Whether the Commission reasonably and lawfully may refuse to reflect Federal income taxes as a deductible expense in the overall computation of "operating expenses, depreciation and depletion expense, taxes and exploration and development costs," as was done *(R. V. 1, p. 58)*.

Whether the Commission reasonably and lawfully may refuse to consider or reflect Federal income taxes in the base figure of "expenses and return" adopted by it for the "cost of service allocation," so-called *(R. V. 1, pp. 58, 61)*.

Whether the Court of Appeals, in approving the exclusion of all Federal income taxes from "expense," from "cost of service," and from the "cost of service allocation,"

by the Commission, as "legally justified" *(R. V. 3, p. 1337)*, has performed its judicial function under *Section 19(b)* of the Gas Act or has proceeded under the correct rules of law.

7.

Allocation of Cost of Service.

The Commission adopted the so-called "demand and commodity" method for allocating costs *(R. V. 1, p. 59)*. It gave no consideration whatever as to whether, under the requirement that it "must make a separation of the regulated and unregulated business" *(Panhandle Eastern Pipe Line Co. v. Federal Power Comm.*, 324 U.S. 635, 65 S. Ct. 821, *Colorado-Wyoming Gas Co. v. Federal Power Comm.*, 324 U.S. 626, 635, 65 S. Ct. 850, 854), a separate allocation of investment and operating cost between the regulable and non-regulable properties was necessary in this case. The general method here employed was utilized in the *Colorado Interstate Gas Company* case. With respect to such method, Mr. Justice Douglas in that case declared: "The problem is to allocate to each class of the business its fair share of the costs. * * * Allocation of costs is not a matter for the slide rule. It involves judgment on a myriad of facts. * * * Under this Act the appropriateness of the formula employed by the Commission in a given case raises questions of fact not of law. * * * Considerations of fairness, not mere mathematics, govern the allocation of costs" (324 U.S. 581, 589, 591, 65 S. Ct. 829, 833, 834).

There are no Commission findings of fact disclosing the governing "considerations of fairness" or what "judgment" factors entered into the adoption of "the staff's method" and the Commission's ultimate conclusion that such method "as applied was fair and reasonable" *(R. V. 1, pp. 59-61)*. "Mere mathematics," molded by the desires of the Commission, in fact controlled, as the record discloses *(R. V. 1, pp. 55, 57, 58, 61; R. V. 3, pp. 1187-1213)*.

We illustrate from the record certain of the manipulative devices of allocation by which the Commission can and does at will control, without restraint, the basis and foundation of its so-called "cost of service allocation."

The Commission, *as a part of and for the sole purpose of*

its so-called "cost of service allocation," excluded entirely *all* Federal income taxes (in excess of $310,000) from deductible expenses, and therefore from the base figures of "cost of service" *(R. V. 1, p. 57)*. Such elimination was not based on any finding of fact whatever, or on any disclosure of "considerations of fairness," or factors of "judgment" but rests purely on an "if" and untrue supposition *(R. V. 1, pp. 57, note, 58, 61)*.

Similarly, and again *as a part of and for the sole purpose of its so-called "cost of service allocation,"* the Commission "concluded" that *the operating expenses* of this petitioner should be "credited" annually with the asserted "average annual excess profits" of $380,000 a year from the natural gasoline extraction operations here in question *(R. V. 1, p. 55)*. This procedure, as intended, operated directly to reduce the "total cost of service" by the amount of $380,000 a year and the "cost of service" allocated to the regulable business by $224,700 a year *(R. V. 1, p. 58; Comm. Br., Ct. of Appeals, p. 37 note)*. Aside from the overall illegality of the expropriation of certain of the Cities Service *Oil* Company natural gasoline extraction plants, business and earnings *(R. V. 1, pp. 53-55; R. V. 2, pp. 771-773, 792, 798, 800, 802, 1021)*, the "revenue from processing natural gas" is required to be credited to "gas revenues" *(Comm. System of Accounts, Sec. 617. See also Section BA 747, 1, and note, R. V. 3, pp. 1244-1245)*. This is so because the item is in fact a revenue item and not an expense item.[5]

The Commission thus refused to permit either of the foregoing items or any part thereof to enter into the overall or allocated "cost of service" *(R. V. 1, p. 61)*.

The Court of Appeals flatly refused to examine, consider, criticize or review any part of the so-called allocation process indulged by the Commission, on the ground that the administrative action is final and the reviewing court is without any authority whatever of any kind in the premises *(R. V. 3, p. 1339)*.

The questions presented then are:

Whether the Commission order in the absence of "the basic and essential findings on which administrative orders rest" can stand.

Whether the ultimate conclusion of the Commission that its allocation is "fair and reasonable" is subject to judicial inquiry and review, to ascertain whether the Commission addressed itself to the evidence, whether the evidence is sufficient and whether the Commission conclusion is "fair and reasonable" or capricious and arbitrary.

Whether the Court of Appeals in its refusal in this case to enter into any process of review whatever on the issue of allocation, has proceeded under the correct rule of law *(Sec. 19(b) of the Gas Act)*.

As bearing directly on the so-called "end result" of the rate reduction order herein, the Commission relied upon the dividend and funded debt reduction record of petitioner for "the 16-year period ending November 30, 1942," showing, so it is said, an average return of approximately 14% on the investment in the property, that is, on the Commission "cost" rate base theory *(R. V. 1, pp. 51-52)*.

Whatever dividends were paid and whatever reductions were made in the funded debt during any period in the past were not made under rate schedules conformable to the rate reduction order herein. So just what materiality past earnings under different and higher rate charges could have upon the "fairness and reasonableness" of the rate reduction order herein under review is inexplicable.

The "end result," viewed on the basis of the past financial stability of the company *(Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 288) whatever its merits, encounters insuperable difficulties under the "cost of service allocation" method of the Commission, that is where, as here, there is no separation of the plant, property, operations and earnings of the utility as between the two classes of business—that which is regulated and that which is not regulated.

The 16-year record of Company operations, relied upon by the Commission, related to and covered *all* property, business, operations and earnings of the petitioner, both those now regulated and those not now regulated by the Act. The Commission order of rate reduction herein relates to and covers, and lawfully can relate to and cover, only the

business regulated under the Act. There is no separation in the Commission "cost of service allocation" of the regulated and unregulated properties and business of the petitioner.

The unregulated business lawfully may not be required to carry the regulated business or any part of it, any more than the regulated business lawfully may be required to carry any part of the unregulated business. The earnings from the unregulated business alone might be sufficient to enable the Company to maintain the financial stability of the utility, and yet at the same time the end result of the rate reduction order upon the regulated interstate sales for resale business, to which alone the order is applicable, may be arbitrary. In any event, without a separation of that portion of the properties, operations, expenses and earnings attributable to the regulated business, there is no possible way, other than guesswork, to determine whether the end result of the rate order upon the financial stability of the utility, with respect to that part of the business only which it purports to regulate, is "unjust and unreasonable." The result is that the present and future financial condition of this petitioner, resulting from and the end result of the reduction in the rates of the regulated business only, can not be measured, in fact, in logic or in fairness, without separation of the properties, expenses and earnings attributable to that part of the business.

The question presented then is: Whether here, in order to determine, by the test of resulting financial condition, the reasonableness or arbitrariness of the end result of the rate order, it is necessary that there be a separate allocation of property, operations and earnings between the regulable and unregulable business of this petitioner.

8.

Due Process of Law.

The Commission throughout its opinion has announced general, vague and argumentative ultimate conclusions instead of making a "suitably complete statement" of the facts with respect to the several issues joined herein and thereupon declaring "the basic or essential findings" of facts flowing from substantial evidence "required to support

the Commission's order." Particularly is this true, as the record abundantly shows, as to Commission findings and conclusions, omission of findings, and findings not supported by evidence in relation to "rate base," "existing depreciation," "natural gasoline operations," "federal income taxes" and "allocation" *(R. V. 1, pp. 31-32, 44, 45-46, 53-54, 57, 59-61)*.

The Commission throughout its opinion has misconstrued and misapplied the Natural Gas Act and has ignored controlling law, among other things, with respect to the "scope of its jurisdiction," "rate base," "regulation of producing and gathering properties," "natural gas operations," "Federal income taxes" and "allocation" *(R. V. 1, pp. 31-32, 37, 53-55, 57, 59-61)*.

The Commission has not borne the burden of proof imposed upon it by law, particularly in connection with the issues of "rate base," "existing depreciation," "natural gasoline operations," "Federal income taxes," and "allocation" *(R. V. 1, pp. 31, 43-47, 53, 57, 59-61)*.

The Court of Appeals, on such a record, has denied to this petitioner any real review as provided by *Section 19(b)* of the Act, under the asserted concept of administrative finality and want of power in the reviewing court to consider and act upon patent error *(R. V. 3, pp. 1327, 1328, 1339)*.

The Court of Appeals has denied relevance to the facts, conditions and factors surrounding the exercise of administrative judgment and discretion and has refused to consider, to examine or to review them, on the assigned reason that the Commission has been given a "free rein" in the discharge of its "administrative prerogatives" *(R. V. 3, pp. 1327, 1328, 1339)*.

The Court of Appeals has erected presumption after presumption of such weight and conclusiveness that the statutory review is foreclosed before the judicial inquiry commanded can be launched *(R. V. 3, pp. 1328, 1332, 1339)*.

The Court of Appeals has assumed, as did the Commission, that whatever findings and conclusions the Commission made, *even though unsupported by substantial evidence,* cannot be set aside by the courts unless the contrary is af-

firmatively established by the petitioner *(R. V. 3, pp. 1333, 1336, 1337)*.

The questions presented then are:

Whether this petitioner has been denied the substance of due process by the Commission contrary to the requirements of the Natural Gas Act and Fifth Amendment to the Constitution of the United States.

Whether the Court of Appeals, by its refusal to afford to this petitioner the reality of review, as provided and required by *Section 19(b)* of the Gas Act, has denied to this petitioner due process of law under said Act and the Fifth Amendment to the Constitution of the United States.

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

As disclosed in the "Questions Presented," *supra,* the action and rate reduction order of the Commission and the opinions and judgment of the Court of Appeals, both under examination on this review, involve fundamental and grievous errors, relating particularly to: the scope and character of the statutory duty of review imposed by law upon the Court of Appeals; the reach and area of the rate-regulatory authority of the Commission over this petitioner; the manner in which the lawful rate-regulatory authority of the Commission may be exercised; the probative substance of the evidence as to the issues of material fact herein; the propriety and legality of the ultimate findings and conclusions upon which the order of the Commission is predicated, and the propriety of the several conclusions and determinations of the Court of Appeals.

This "Summary and Short Statement" of facts and issues of general materiality is supplemental to the matters set forth, *supra,* under the subject title "Questions Presented."

Petitioner, a subsidiary of Cities Service Company, owns and operates an integrated natural gas pipeline system *(Map, R. V. 3, p. 1181)* consisting of 4300 miles of main, branch and field lines, together with appurtenant and ancillary facilities, including compressor stations, dehydrating and purification plants, storage fields, meter stations and ex-

tensive telephone lines and circuits *(R. V. 1, pp. 30-31; R. V. 3, p. 1324)*.

The system extends from the Texas Panhandle field and various fields in Oklahoma, Kansas and Missouri, to various cities, towns and communities and other places of sale in Oklahoma, Kansas, Missouri and Nebraska, including the metropolitan areas of eastern Kansas and western Missouri.

The present system had its origin in 1904. During the period to 1926, numerous pipelines were constructed by predecessor companies from the then producing Kansas gas fields to Kansas City, Missouri, Lawrence, Topeka, Atchison and cities and towns in Kansas, and to natural gas fields in Oklahoma *(R. V. 3, p. 1324)*.

By 1926, the properties above referred to were acquired by petitioner (prior to 1926 the name thereof was Empire Natural Gas Company) *(R. V. 3, p. 927)*, including the pipeline systems of the original enterprises, The Kansas Natural Gas Company group (in receivership 1912-1921) and the Wichita Natural Gas Company group *(R. V. 3, pp. 1100-1107, 947-953)*.

The pipeline to the Texas Panhandle field was placed in service in 1928, the field lines having been laid and a number of wells drilled in 1927 *(R. V. 3, p. 1107)*.

In the period from 1926, a large expansion of the pipeline system took place. Approximately 50% of the present *mileage* of mains and gathering pipeline system was constructed since the year 1926. This amounts on the "cost" basis also to more than 50% of total plant costs *(R. V. 1, p. 91)* and about 76% of existing property other than reserves *(R. V. 1, p. 32)*.

Prior to the year 1927, when the company first began producing gas from its leases in the Texas Panhandle Gas field, the source of gas supply was from production and purchases in about 125 gas fields located in the states of Kansas and Oklahoma *(R. V. 1, p. 107; R. V. 3, p. 1109)*.

The Texas Panhandle acreage had been in process of acquisition since 1917; years before a portion of that area became a proven and producing field, now known as the Texas Panhandle field *(R. V. 1, pp. 107-109)*.

Petitioner owns extensive proven and producing gas reserves in the Panhandle Field in Texas, the Hugoton Field in Kansas and Oklahoma and numerous other fields in Oklahoma and Kansas *(Op. Ct., R. V. 3, p. 1324.* The reserves in the Hugoton field now are, but in 1941 were not, connected with petitioner's pipeline system *(R. V. 1, p. 84).*

The pipeline system is connected with and is served from the producing wells of the petitioner in the Texas Panhandle and other fields in Kansas and Oklahoma *(R. V. 3, p. 1324).*

The petitioner, in 1941, served from its pipeline system about 265 cities, towns and communities in Oklahoma, Kansas, Missouri and Nebraska under various contracts of "sale for resale" and a considerable number of industrial and other direct sale customers in the same states, of which latter sales 95% in volume were in Oklahoma and Kansas. The "sales for resale" were 61,425,000 M.c.f., aggregating $12,903,500, and the "direct sales were 40,700,000 M.c.f., aggregating $4,335,500" *(Comm. Ex. 17, R. V. 3, pp. 1151, 1324).*

In 1941, the petitioner produced from its own wells 43% of its total natural gas requirements, of which about 46,000,000 M.c.f. were produced in the Panhandle field and about 1,000,000 M.c.f. in Kansas and Oklahoma. Of the gas purchased in that year (61,000,000 M.c.f.), about one-half thereof was purchased in each of the states of Kansas and Oklahoma *(Comm. Ex. 14, R. V. 3, p. 1119).*

The leaseholds and natural gas rights of petitioner in the Texas Panhandle, Hugoton and other Oklahoma and Kansas fields are summarized as of 1941 from the record in accordance with Commission witnesses, exhibits and the opinion of the Commission by Judge Phillips in his dissenting opinion *(R. V. 3, pp. 1342-1344)* as follows:

Leaseholds and Natural Gas Rights
Texas Panhandle Field

	Acres	Per cent of total Acreage	Cost allowed in rate base	Gas reserves 12/31/41 M. c. f.	Production 1941 M. c. f.
	68,086	66.67	zero*	1,089,383,786	
	34,041	33.33	$ 554,697.08	544,679.135	
	10,975	(non-productive)	o	o	
	*Allowance for title papers and title examination		1,776.74		
Total	113,102		$ 556,473.32	1,634,062,921	42,122,613 or 97.83% of petitioner's total production

Oklahoma and Kansas Fields
(exclusive of the Hugoton Field)

	424,969	$ 545,374.18	4,794,964	1,029,157

Hugoton Field

	182,182	$ 542,501.00	1,821,820,000	(not in production in 1941)
Total	720,253	$1,644,349.00		

The total cost of gas produced (including expense of production, depreciation, depletion and return at Commission "cost" rate base) and of purchased gas in 1941, according to the Commission staff, was $3,512,611 *(Comm. Ex. 30, R. V. 3, pp. 1187, 1197-1200. Note:* The material on lower half of page 1198 should appear on lower half of page 1200. Error in arrangement occurred during printing.) The Commission in its opinion and order made no findings, reconciliations or other disclosures whatever as to the adjustments made by it in the Commission staff figures *(R. V. 1, pp. 52-59)*. Accordingly, the staff figures contained in *Commission Exhibit 30,* are used here.

The open field price paid for purchased gas (56,067,333 M.c.f.) was $2,716,722, an average of $.048 per M.c.f. *(Comm. Ex. 16, R. V. 3, p. 1145)*. However, by Commission Exhibit 33 *(R. V. 3, p. 1246)*, the amount of purchased gas is given as 61,314,818 M.c.f., and the cost thereof, according to Commission Exhibit 30 *(R. V. 3, p. 1198)*, was $2,639,789, an average of $.043 per M.c.f. The considerable differences are: in volume, 5,247,248 M.c.f. and in price, $76,933. Again, there

are no findings, reconciliations or other disclosures of any kind in the opinion or order of the Commission, indicating what volume and cost figures the Commission actually adopted, and why *(R. V. 1, pp. 52-59)*.

The figure of $2,639,789 *(Comm. Ex. 30)* obviously includes cost of production, depletion of reserves, depreciation of production facilities and return to the producers from whom the gas was purchased by petitioner.

The total production "cost" (including production expense, depletion of reserves, depreciation of production facilities and return) of petitioner for its own production in 1941 of 43,151,770 M.c.f., therefore, was $872,822 *according to the Commission staff figures (Comm. Ex. 30)*, an average price of $.0202 per M.c.f. *(R. V. 3, pp. 1119, 1197-1200)*. Here again the Commission opinion and order is without findings or other clarifying disclosures.

The natural gas reserves of petitioner were put in the Commission "cost" rate base at $1,644,349 *(R. V. 1, pp. 37, 50)*. Depletion therein to December 31, 1941, counsel for the Commission contended in the Court of Appeals by record references *(R. V. 1, p. 47, footnote 26; R. V. 3, p. 1051)* was $179,100, leaving a net "cost" rate base of $1,465,249, upon which a 6½% return would be $95,241, an average price of $.00201 per M.c.f.

It is to be observed that the 1941 production from two-thirds of the productive acreage (68,086 acres) in the Texas Panhandle field (28,081,742 M.c.f.) carried with it no return or price whatever, there being no rate base for such reserves. Petitioner for such gas was allowed the bare expense of production and nothing else. In short, this vast volume of gas was given to petitioner's customers.

It is also to be observed that the production from the remaining one-third of the productive acreage (34,041 acres) in the Texas Panhandle field (14,040,871 M.c.f.) carried a return or price of $.0023 per M.c.f., to which the Commission added the expense of production.

On the other hand, the 1941 production of gas in the expiring Oklahoma and Kansas fields (1,029,157 M.c.f.) under

the Commission "cost" theory produced a return or price of $.031 per M.c.f., on the basis of a 6½% return of $32,500 on the depleted cost of the reserves of approximately $500,000, to which the Commission added the expense of production.

For the gas produced by petitioner in 1941 in the entire Texas Panhandle field (6½% of $32,500 on the depleted cost of approximately $500,000), petitioner by way of return was allowed by the Commission formula a price of $.0007 per M.c.f. for its production of 42,122,613 M.c.f. For the gas produced by petitioner in the same year in the then expiring Kansas and Oklahoma fields (6½% on the depleted cost of approximately $500,000), petitioner by way of return was allowed by the Commission formula a price of $.0218 per M.c.f. for its production of 1,029,157 M.c.f.

Under the Commission "cost" *rate base,* the Texas Panhandle reserves (113,102 acres, 1,634,062,921 M.c.f.) and the Hugoton reserves (182,182 acres, 1,821,820,000 M.c.f) are put in the *rate base* at a mere shadow of a fraction of a mill per M.c.f. of gas reserves.

On the other hand the reserves in the expiring Kansas and Oklahoma fields (424,969 acres, 4,794,964 M.c.f.) are put in the *rate base* approximately at 11.4 cents per M.c.f of gas reserves *in the ground*—a figure more than twice the open *field* price of natural gas in the area.

In such manner does the Commission rigid "cost" rate base operate, in this case, when applied to the natural gas rights and leaseholds of this petitioner.

In the interest of brevity, such additional record facts relating to each of the several specific issues and questions presented herein, as appear to be necessary or desirable adequately to discuss such issues and questions, will be submitted in the attached brief argument, *post.*

"SPECIAL AND IMPORTANT REASONS" FOR GRANTING THE WRIT OF CERTIORARI HEREIN.

In conformity with the requirements of the applicable rules of this Court, the substantial reasons, discussed with greater particularity in the short brief of the argument hereto attached, which it is contended should move this Court to allow the writ of certiorari herein sought, are summarized as follows:

None of the several issues of fact and law as herein presented as yet have been adjudicated and settled finally by authoritative pronouncements of this Court. There exists a broad public interest comprehending all natural gas companies, all producers of natural gas and the consuming public generally. The present state of uncertainty and confusion, as to the extent of the authority of the Federal Power Commission and the lawful manner of its exercise, as well as the duty of courts of review acting pursuant to the mandates of *Section 19(b)* of the Gas Act, can be resolved only by this Court through its determination of the questions and issues here presented. No natural gas company heretofore has been accorded a full and complete review under the statute of any rate reduction order of the Federal Power Commission. Such circumstance has contributed materially to the presently existing confusion and doubt as to both the public and private rights and duties involved.

The grievous injury and remediless injustice visited upon this petitioner by the order of the Commission and by the judgment of the Court of Appeals herein is manifest from the entire record which is replete with prejudicial error, as follows:

Jurisdiction of the Commission.

The Commission has assumed herein that it is possessed of virtual administrative finality and that it is not required except by generalized ultimate conclusions of reasonableness and propriety to disclose the specific evidentiary and other foundations of its action.

The Commission in its opinion and order herein discarded relevant, uncontroverted and controlling evidence upon is-

sues of material fact; indulged conjecture, guess and speculation in the absence of substantial or any evidence to permit the conclusions announced; failed to make findings of basic and essential facts; cast aside the applicable law and controlling judicial decisions in numerous respects; and generally while adhering to the *forms* of "due process," erroneously has declared both the facts and the law to be in conformity with the non-existent statutory policies and objectives, which it has undertaken to establish. As a result, the Commission action in this case was arbitrary and contrary to law.

Scope of Review.

The Court of Appeals *(R. V. 3, pp. 1323-1339)* under its announced concept that the authority and "broad area of discretion" of the Commission for all practical purposes is without legal restraint and "virtually supreme," and that on review the courts of the land are powerless to afford relief against or examine judicially a rate reduction order of that body even if it is or "appears to be illogical and unfair" or arbitrary, has misapprehended and disregarded both the mandate of the Congress to it embodied in *Section 19(b)* of the Natural Gas Act, the heretofore settled and the present course of authoritative judicial decision and the basic concept of our American structure of government which does not contemplate the "free rein" of unbridled power in the hands of any public officials, be they ever so "expert," as finders of the facts or as expounders of the law.

The Court of Appeals in its opinion and consequent judgment herein has not proceeded under a correct rule of law, by reason of the assertions and assumptions made by it: that the Commission has been given by "the courts," not by Congress, a "free rein," notwithstanding *Section 19(b)* of the Natural Gas Act, but as that section assertedly has been construed by the courts *(R. V. 3, p. 1327)*; that Commission action since it, as it is said, "is the product of 'expert judgment' " is correct as "an almost conclusive presumption" *(R. V. 3, p. 1328)* and that "the administrative judgment has been declared virtually supreme" *(R. V. 3, p. 1339)*. The foregoing mean that the Commission order is immune from judicial review on the facts. Such is not the law.

The Court of Appeals, while patently solicitous lest it "trespass upon the administrative prerogatives" *(R. V. 1, pp. 1327-1328, 1329-1333, 1333-1335, 1335-1336, 1337, 1337-1339)*, clearly was concerned not at all either in recognizing or in performing any duty and function of actual judicial review whatever herein under *Section 19(b)* of the Gas Act. *(Connecticut L. & P. Co. v. Federal Power Comm.*, 324 U.S. 515, 65 S. Ct. 749).

The Court of Appeals, relying on its own assertion that petitioner did not offer evidence as to certain fact issues *(R. V. 3, pp. 1333, 1335, 1337)*, ignored the correct rule of law that in a Commission inquiry as to the reasonableness of rates and charges, the burden of actual proof rests upon the Commission to establish in the rate case the fact of unreasonableness and the amount thereof, before lawfully it may enter any order of rate reduction, and that under the standards of *Section 19(b)* of the Gas Act that burden of proof must have been sustained by "substantial evidence," else the Commission order cannot stand on review.

Rate Regulation of Gas Reserves, Production and Gathering.

The Commission ignored the lawful ambit of its statutory authority herein, by its inclusion of the natural gas rights and leaseholds and other production and gathering properties in the Commission "rate base" of the regulable property and business, contrary to *Section 1(b)* of the Gas Act.

The Court of Appeals *(R. V. 3, pp. 1328-1329)*, in its unsupported conclusion "that under the prevailing view, the Commission did not exceed its jurisdiction by the inclusion of the production and gathering facilities in the rate base * * *", has misconceived the force, effect and decision of this Court in the consolidated cases of *Colorado Interstate Gas Company* and *Canadian River Gas Company v. Federal Power Commission*, 324 U.S. 581, 65 S. Ct. 829, in that no majority of this Court has declared "the prevailing view" thus attributed to it by that Court.

That Court *(R. V. 3, p. 1329)* confused or disregarded the elementary difference in fact, in reason and in consequences,

between "*inquiring into and considering* the production and gathering properties in respect of depreciation, operating expenses and revenues in so far as they had bearing upon the exercise of its jurisdiction to determine just and reasonable rates of natural gas transported interstate for resale for public consumption" and "*reflecting* the production and gathering facilities of a natural gas company *in the rate base* * * *." (Emphasis added.)

The conclusion of that Court *(R. V. 3, p. 1329)* that "The Supreme Court, after review and discussion * * * was of the opinion that it (The Gas Act) did not 'preclude the Commission from reflecting the production and gathering facilities * * * in the rate base * * *' " is not a correct statement of the decision of this Court relied on in that behalf.

Rate Base of Natural Gas Reserves.

The Commission did not follow the correct rule of law (*See Colorado Interstate Gas Co. v. Federal Power Comm.*, 324 U.S. 581, 605, 65 S. Ct. 829, 840 and cases cited) in its determination and conclusion that when, as the Commission found herein, the so-called "actual legitimate cost of the Company's property is accurately ascertainable from the books and records," the Commission is required by *Section 6(a)* of the Gas Act in its fixation of rate base to use "actual legitimate cost" and only actual legitimate cost.

The Commission did not follow a correct rule of law in excluding all evidence of "fair value" as "irrelevant and immaterial" *(R. V. 3, p. 1331)* in its determination of "rate base."

The Court of Appeals *(R. V. 3, pp. 1329-1333)*, in disregard of the law and its mandated duty of review, committed grievous and prejudicial error:

In its refusal *(R. V. 3, p. 1331)*, notwithstanding and "in the face of fundamental considerations of fairness to the contrary," even to examine and test the order of the Commission as measured by the record to determine whether, as stated by this Court, "it is invalid, because it is unjust and unreasonable in its consequences" and produces an "arbitrary result."

In its failure to realize and consider that the Commission "whose duty it is to make 'the pragmatic adjustments called for by the particular circumstances' " *(R. V. 3, p. 1339)* precluded itself entirely from performing that equitable function by declaring, contrary to law, that it (the Commission) is required by *Section 6(a)* of the Natural Gas Act in all cases to exclude from the record all consideration and evidence of "fair value" of the property of petitioner in its rate base determination and thereby also is limited as a matter of law to "actual legitimate cost" as the sole measure of rate base and every element thereof in all cases *(Op. Comm., R. V. 1, pp. 31-33, and cases cited).*

In its assertion *(R. V. 3, p. 1333)* that the "pronouncements" of "the majority" of this Court prohibit all judicial inquiry into the propriety of "including the production properties in the rate base at actual legitimate cost," in this and in every other case.

In its legal conclusion *(R. V. 3, p. 1333)* that the statutory standard of "just and reasonable," as distinguished from "arbitrary" action, is circumscribed and disposed of solely by whether or not the Commission action "results in the impairment of the financial integrity of the company as a public utility."

The conclusion of that Court *(R. V. 3, p. 1333)* that the propriety or impropriety of including the production properties in the rate base at actual legitimate cost is "no longer a debatable question" and thus, as a matter of law, is not reviewable, is an erroneous statement and conclusion of law, and of necessity precluded that Court from any consideration of "pragmatic adjustments," of that which is "just and reasonable" and of the "end result," upon which we are told authoritatively the decision of the reviewing court "in each case must turn."

In its declaration *(R. V. 3, p. 1332)*, "We have not the right to intercede unless it is *conclusively shown* that failure to give consideration to the fair value of the properties, including the valuable leasehold estates, will prevent the company from operating successfully as a public utility." This statement is not supported by the cases cited. Under this

expressed view of that Court, all considerations of unfairness, unreasonableness, arbitrary action, pragmatic adjustments and end result are in reality the sole, absolute and unreviewable prerogatives of the Commission. Such is not the statutory standard of "fair and reasonable" or otherwise the law of this land.

Existing Depreciation and Depletion.

The Commission, in disregard of controlling law, has made basic and essential findings and conclusions herein as to "existing depreciation" which are not supported by evidence and are contrary to the uncontradicted evidence *(R. V. 1, pp. 44, 45-46)*.

The Court of Appeals *(R. V. 3, pp. 1333-1335)* disregarded the fundamental and recently re-declared requirements of law that there must be appropriate and specific findings of fact, that "The findings of the Commission as to the *facts*" must be "supported by *substantial* evidence," and that the courts are not authorized under *Section 19(b)* to make findings and substitute them for those of the Commission, which this Court herein in fact has done.

That Court failed to examine and appraise, under the statutory requirement of "substantial evidence," the sufficiency of the evidence of the one Commission witness on the subject of "depreciation and depletion," to support the Commission's "finding * * * of the facts" and conclusion on that subject. In this connection that Court recited merely the broad, general statements and conclusions of the witness on his direct examination. No notice is given to the factual content and probative value of the free and easy conclusions of that witness or to the actual insufficiencies and inconsistentencies of his testimony developed on his own cross-examination. This conception and action of that Court does violence to the statutory standard, and denies all review in fact of the "finding * * * as to the facts," a duty specifically imposed upon that Court by the Act. The general and specific legal import of "substantial evidence" is not satisfied by such selected and fragmentary excerpts from the testimony of a witness, without regard to his entire testimony and

consideration of the force and effect of his testimony as a whole *(Connecticut L. & P. Co. v. Federal Power Comm.,* 324 U.S. 515, 65 S. Ct. 749).

That Court *(R. V. 3, pp. 1333-1334)* disregarded entirely and, therefore, made no determination whatever of, the substantial issue of "The $2,200,000 erroneously added by Commission 'adjustment' to petitioner's depreciation reserve, as fixed by the Commission" *(R. V. 1, pp. 45-46; R. V. 1, pp. 207-208).*

Natural Gasoline Extraction Operations of Cities Service Oil Company.

The Commission disregarded the controlling law (See *Smith v. Illinois Bell Telephone Co.,* 282 U.S. 133, 144, 151-153, 51 S. Ct. 65, 67, 70; *Section 1(b)* of Gas Act) in expropriating and treating the natural gasoline extraction plants, business and earnings of Cities Service *Oil* Company "as if they belonged to petitioner"; and in treating such plants, business and earnings as though they were subject to the rate-regulatory control of the Commission.

The Court of Appeals *(R. V. 3, pp. 1335-1336)* misapprehended and misapplied the applicable law in approving as a matter of law the Commission action and order treating the natural gasoline extraction plants and business of Cities Service Oil Company "as if they belonged to petitioner."

That Court *(R. V. 3, pp. 1335-1336)* in its passing reference to the Commission so-called "average excess profits for the years 1939 to 1942" of such plants and business, ignored the fact, uncontradicted in the record, that the Commission in its purported ascertainment of such "profits" refused to reflect as a deductible expense Federal income taxes in any amount or at all.

That Court *(R. V. 3, pp. 1335-1336),* consonant with its contention that Commission action is "virtually supreme" and attended with "an almost conclusive presumption" in its favor, concluded, without independent examination of and judicial appraisal of the meaning and import of the record, as measured by the requirement of "substantial evidence," that the Commission conclusions are immune from attack and review as a matter of law.

Federal Income Taxes.

The Commission did not adhere to the correct rule of law (See *Galveston Electric Co. v. Galveston,* 258 U.S. 388, 399, 42 S. Ct. 351, 356) in eliminating all Federal income taxes from "deductible expense," from "Cost of Service" and from "Cost of Service Allocation" *(R. V. 1, p. 57),* and the Court of Appeals committed like error in approving and affirming such Commission elimination of Federal income taxes.

The Court of Appeals *(R. V. 3, p. 1337)* misstated and, therefore, misconceived the so-called "thesis" upon which it is said the Commission proceeded in its denial of all Federal income taxes as an expense deduction in arriving at the over-all net earnings of petitioner for the year 1941, for the purposes of the Commission Federal income tax "adjustment," so-called, *(Comm. Ex. 41, R. V. 3, p. 1264; R. V. 1, p. 57 and note).*

That Court then concluded *(R. V. 3, p. 1337)* that "the petitioner may not charge as an expense that which it cannot lawfully earn," which statement, whether true or false, bears no relation whatever either factually, logically or legally, to the issue of "Federal income taxes" presented in this record.

That Court *(R. V. 3, p. 1337),* contrary to law, assumed and concluded that the Commission lawfully may limit the over-all earnings of this petitioner (described by the Court as "permissible earnings") upon its non-regulable sales and earnings, as well as upon its regulable sales and earnings.

That Court, so far as the opinion discloses, was wholly unaware of the fact, uncontroverted in the record, that all other expenses of both regulable and non-regulable operations and sales, except Federal income taxes, were, as by reason and law required, deducted in the Commission's staff determination of over-all net earnings for Federal income tax purposes. For instance, the "cost" or purchase price of all natural gas sold only in the non-regulable operations was used in the Commission's staff income tax computation to support the Commission conclusion that there was no Federal income tax liability upon "permissible earnings."

In short, and in defiance of law, fairness and decency, all expenses of the non-regulable operations, sales and earnings (both less than and more than 6½%) were utilized to lend color and the badge of propriety to the Commission order that all Federal income taxes must be paid by the "non-jurisdictional sales."

That Court, in the use of the phrases "permissible earnings" *(R. V. 3, p. 1337)* and "permissible return from the adopted rate base" *(R. V. 3, p. 1337; Op. R. V. 1, p. 57, Note)* disclosed a definite misapprehension, prejudicial to this petitioner, of the lawful "prerogatives" of the Commission under the Natural Gas Act, both as enacted and as construed most recently by this Court.

That Court concluded *(R. V. 3, p. 1337)* "We must therefore assume on this record that the Commission's statement • • • is correct" to the effect that it "did no more than allocate to the non-jurisdictional sales the cost of earnings which were solely attributable to it." This conclusion is predicated upon the assertion by that Court that petitioner "offers no affirmative computation tending to show its tax liability upon the permissible rate." The conclusion of that Court is not in conformity with law, and its assertion is not conformable to fact.

Allocation of Cost of Service.

The Commission, as disclosed by its conclusions herein *(R. V. 1, pp. 59, 61)*, did not give consideration as to whether properly to make allocation between the regulated business and the unregulated business, a separate allocation of plant, property and earnings should have been made; did not make "basic and essential findings" by which "the path which it followed can be discerned"; and did not reflect in its "allocation of cost of service," so-called, substantial items which properly and lawfully should have been incorporated therein *(R. V. 1, pp. 55, 57)*.

The Court of Appeals *(R. V. 3, pp. 1337-1339)* made some descriptive recital of the Commission so-called "demand and commodity" method of "allocation of cost of service," and thereafter set out several short quotations from various opinions of this Court, including from the opinion of Mr.

Justice Douglas in the consolidated *Colorado Interstate Gas Company* and *Canadian River Gas Company* cases, the following: "The appropriateness of the formula raises questions of fact, not of law," but that Court did not quote from the same opinion the further statement that "Considerations of fairness, not mere mathematics, govern the allocation of costs." The Court of Appeals then concluded that since "the administrative judgment has been declared virtually supreme"—"we shall not criticize that which we are powerless to correct. * * * We cannot say on this record that the application of the formula is so wholly unrelated to the facts as to produce an illegal or reversible result." Thus, without respect to or differentiation between the general "method" or "formula" adopted and the actual detailed pattern imposed, without notice of or regard to "considerations of fairness," and additionally in derogation of the admitted statutory standard of "substantial evidence" applicable alike to all and every finding * * as to the facts," that Court, in its willing retreat from fancied "trespass upon the administrative prerogatives" refused even to enter into any process of actual review herein, on the assigned ground that lawfully it may not so do. Such is not the law.

That Court *(R. V. 3, p. 1339)* apparently assumed, but did not decide, as related to the facts and circumstances of this case, that the Commission "allocation of cost of service is a fundamentally correct and permissible method of effecting a separation of the regulable from the non-regulable sales," operations and properties. This petitioner, as of right, is entitled to a judicial determination of this issue.

That Court *(R. V. 3, p. 1339)* considered the problem of "allocation of cost of service" to be an "economic one," as well as one of engineering, to be resolved by "experts" through "the exercise of informed judgment" in such manner as is "reasonable in view of the particular operations and circumstances of the system in each case." *Nevertheless, that Court refused to examine or consider the evidentiary foundations and propriety of the determination of the "economic" and other relevant factors by the sole Commission staff witness on that subject.* Further, that Court neglected to examine the qualifications of that witness and the

reasonable basis for his unsupported conclusions in support of the actual frame-work of the so-called "allocation" herein. This witness testified that he had never before prepared such a "cost allocation" *(R. V. 1, p. 825)*, although, according to that same witness, as quoted by that Court, the problem is one of such difficulty "that engineers and economists have been studying for many years" upon it. Real review under *Section 19(b)* of the Act, predicated upon the record herein filed as required by law, lawfully may not be denied.

End Result and Due Process.

Due process which has been described in this Court as "the rudiments of fair play" finds expression in the declaration of this Court that:

> "* * * Once a fair hearing has been given, *proper findings made* and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. *If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.*" (Emphasis added.)
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> *Federal Power Comm. v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S. Ct. 736, 743.

The Commission and Court of Appeals alike failed and refused herein to examine, consider and determine in fact whether the Commission "cost" rate base reduction order was fair and reasonable or produced an "arbitrary result." The Commission precluded itself from such inquiry under its erroneous view of the law that "cost" and cost alone is the only lawful measure of rate base. The Court of Appeals simply refused to make such inquiry.

The Court of Appeals in its opinion and judgment in affirmation of the Commission order has denied in fact and in effect to this petitioner "due process" of law under established, ordered and orderly processes of American government, and particularly the Natural Gas Act and the Fifth Amendment to the Constitution, in that, under the theory of "administrative finality" and "judicial impotency," the Commission determinations of (1) jurisdiction, (2) the man-

ner of exercise thereof, (3) basic material facts, (4) findings and ultimate conclusions, and (5) controlling principles and rules of law, are held by that Court to be immune from the express statutory judicial supervision, examination and review accorded and commanded.

CONCLUSION.

In consequence of the foregoing matters, facts and reasons, more fully considered in the attached memorandum brief, it is submitted, respectfully, that this petition for writ of certiorari should be granted.

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MEMORANDUM BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The foregoing petition for writ of certiorari is addressed to basic conceptions and procedures entertained and followed by the Federal Power Commission and the Court of Appeals herein, in misapprehension or disregard of the facts of this record and the applicable and controlling rules and principles of law. The resulting injuries to this petitioner are great and irreparable.

So far as is possible, this brief discussion will conform in outline to the various subject titles as set forth in "Questions Presented," *supra.*

Administrative Jurisdiction of the Commission and Scope of Review.

It is perfectly clear, from the first subdivision of the opinion of the Court of Appeals, entitled "Jurisdiction of the Commission and Scope of Review"*(R. V. 3, pp. 1327-1328),* that that Court envisioned itself as completely impotent in the face of the "virtually supreme" and unlimited "administrative prerogatives," declared to be possessed by the Commission, and that all issues would be disposed of accordingly, as was done. Thereafter and similarly, all questions of law involving the meaning or judicial construction of the Natural Gas Act were disposed of summarily. Here again the end result of this review was obvious in advance because of the disclosed background philosophy of the Court of Appeals.

The opinion basically is a reiteration of the statements, contentions, arguments and conclusions of the Commission and its staff. It is interspersed, however, with catch phrases, hasty and faulty rationalizations and selected sentence quotes from some of the numerous but divergent concurring opinions in recent decisions of this Court. In several instances, such quotations do not reflect any majority of this Court, and, removed from the setting in which they were uttered and reflecting but part of the thought or idea intended by the authoring Justice, are without legal or judicial significance or as used are in fact misleading. The

foregoing characteristics of the opinion of the Court of Appeals will be considered with particularity later herein.

The opinion throughout manifests that its foundations were laid and the structure thereof developed in the mold of the philosophy of the uncontrolled and uncontrollable supremacy of the executive and administrative branch of the Federal government over the constitutionally coordinate legislative and judicial branches thereof. Whatever language of explanation or extenuation is suggested by that Court, the stern fact remains that that Court has refused to discharge its own obligation of review in accordance with law.

That the scope of review embodied in *Section 19(b)* of the Gas Act is limited, is not questioned. Such is the law. But that the statutory right of review provided is virtually nonexistent in fact, is not the law.[8] The participation of any court in the emasculation of the statutory review carries an implication that the Congress practiced legislative deception and indulged in sophistry in the enactment of the review section.

The phrases "free rein," "broad area of discretion," "expert judgment," "informed judgment," "almost conclusive presumption," etc., etc., do not resolve the issue. Nor is the issue met by such exculpatory assertions as the following: "We are unable to say, as a matter of law, that the Commission's findings on this technical point are legally erroneous" *(R. V. 3, p. 1336)*, or "If some of the specific allocations appear to be illogical and unfair, they necessarily pose technological problems of accounting and finance, upon which the administrative judgment has been declared virtually supreme" *(R. V. 3, p. 1339)*. Since when have the courts been privileged or permitted to abdicate their judicial functions of review because the questions involved are "technical" or "technological"?

After all, Congress in enacting *Section 19(b)* of the Gas Act, which is precisely the same review afforded an ag-

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[8]Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 626, 65 S. Ct. 850;
Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749.

grieved party under several other Federal administrative and regulatory Acts, contemplated and expected as in other cases, that such a far-reaching law as the Natural Gas Act would be administered by "experts" of "informed judgment," who as administrators would have a "broad area of discretion."[9] Nevertheless, the Congress thereupon deliberately incorporated *Section 19(b)* into the Act. Nor is it suggested by that Court that Congress did not know its intentions and the import of its enactment in that behalf.

The Court of Appeals, at the outset of its brief discussion of "scope of review" refers to a statement by Mr. Justice Douglas in the *Hope Natural Gas Company* case (320 U.S. 591, 610), to the effect: "The primary aim of the Natural Gas Act of 1938 was to 'protect consumers against exploitation at the hands of natural gas companies'" *(R. V. 3, p. 1327)*. Whatever may be said for the views of Mr. Justice Douglas in the setting and in connection with the matter then under discussion by him, which was not "scope of re-

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[9]See Federal Power Act, Holding Company Act of 1935, Communications Act of 1934, National Labor Relations Act, Motor Carrier Act, Radio Act of 1927, Interstate Commerce Act, Railway Labor Act, Packers and Stockyards Act, as well as the Natural Gas Act. Under each of these Acts administrative orders entered by those presumed to be "expert" of "informed judgment" and having a "broad area of discretion," nevertheless were set aside by the courts because the findings or conclusions of the Commission or Board were insufficient or were not "supported by substantial evidence." In each instance the reviewing court made an independent examination and appraisal of the record evidence.

Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749;
Securities & Exchange Comm. v. Chenery Corp., 317 U. S. 80, 63 S. Ct. 454;
Saginaw Broadcasting Co. v. Federal Power Comm. (C.C.A., D.C.), 96 Fed. (2d) 554 (Certiorari denied.);
Consolidated Edison Co. v. National Labor Relations Board, 305 U. S. 197, 59 S. Ct. 206;
National Labor Relations Board v. Columbian, etc. Co., 306 U. S. 292, 59 S. Ct. 501;
Eastern Central M. C. Ass'n. v. U. S., 321 U. S. 194, 64 S. Ct. 499;
Federal Radio Comm. v. Nelson Brothers Co., 289 U. S. 266, 53 S. Ct. 627;
Interstate Com. Comm. v. Jersey City, 322 U. S. 503, 64 S. Ct. 1129;
Shields v. Utah-Idaho Cent. R. Co., 305 U. S. 177, 59 S. Ct. 160;
St. Joseph Stock Yards Co. v. United States, 298 U. S. 38, 51, 74-75, 56 S. Ct. 720;
Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 626, 65 S. Ct. 850.

view," is not here material. However it is not a judicial utterance as used by the Court of Appeals in its discussion. If the asserted "aim" was in fact "the primary aim of the Natural Gas Act," Congress most certainly was fully aware of that fact before and at the time of the enactment thereof. Nevertheless, the Congress thereupon deliberately incorporated *Section 19(b)* into the Act.

This section as enacted is available alike to the Commission or a "natural gas company." It is also available to a "natural gas company" whether or not that company is or has been guilty of "exploitation," so-called. And how, we ask, without review, could that Court, or any other court, determine guilt or innocence in the particular case, and if guilty, how could that guilt foreclose review under *Section 19(b)*? Under our system both the innocent and the guilty have legal rights. Moreover, it is inconceivable that Congress intended, or that the law permits, any court to enlarge or reduce at will the scope of review to be accorded by it under *Section 19(b)*, dependent upon its conclusion or guess as to guilt or innocence of "exploitation." Such is not the structure of our legal and governmental institutions, nor the proper or lawful manner of other administration. Thus, the quoted statement here relied upon by that Court cannot have any possible relation to or bearing upon the scope of the directed statutory review. Yet it influenced that Court, else it would not have been incorporated into its discussion of this subject. The idea seems to be that every "natural gas company" is guilty of "exploitation" and, therefore, no "natural gas company" has the right of orderly review, *Section 19(b)* of the Act to the contrary notwithstanding. Such a conception of the law is erroneous, dangerous and highly prejudicial.

The mandate of *Section 19(b)* of the Act is clear. It has not been obscured or sterilized by any pronouncement of the majority of this Court. It is still the law that courts of review, in discharge of their statutory responsibility and obligation, have express jurisdiction and are directed, notwithstanding whatever presumptions of validity properly

may attend the order,[10] to "modify or set aside * * * in whole or in part" any order of the Commission in excess of its statutory jurisdiction, or entered when that body "has not proceeded under a correct rule of law," or if the order does not contain "the basic or essential findings upon which administrative orders rest," or if the findings in the order are not "supported by substantial evidence,"[11] or if the end result is "arbitrary," "unjust and unreasonable," or does not reflect the "pragmatic adjustments called for by the particular circumstances." Administrative agencies are not

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[10]It is true that on review the Commission order "carries with it a presumption of correctness" (*Colorado Interstate Gas Co. v. Federal Power Comm.*, 142 Fed. (2d) 943, 954) and that "informed and expert judgment exacts and receives a proper deference from courts" (*Ohio Bell Tel. Co. v. Public Utilities Comm.*, 301 U. S. 292, 304, 57 S. Ct. 724, 730).

It was said by Mr. Justice Douglas in *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U. S. 591, 602, 64 S. Ct. 281, 288: "Moreover the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences" (assuming of course "a fair hearing has been given, proper findings made and other statutory requirements satisfied," *Natural Gas Pipeline* and *Colorado-Wyoming Gas Company* cases, *supra*).

But it cannot be contended with propriety that Congress, in providing for limited review herein along standardized lines, intended that the grant of authority should be hamstrung by application of presumption after presumption of such bulk and character as to predetermine the result before the judicial inquiry is launched, although such presently is the "end result" in this case under the opinion of the Court of Appeals.

To attribute such an intent is in effect to draw in question the good faith of Congress and to convey also the suggestion that the courts are expected to collaborate in such a sinister design.

[11]This Court repeatedly has defined and delineated with particularity the meaning and application of the term "substantial evidence" as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion"; "it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict * * *"; "evidence which is substantial, that is, affording a substantial basis of fact from which the fact in issue can be reasonably inferred." The desirable freedom from the technical rules of evidence "does not go so far as to justify orders without a basis in evidence having rational probative force" (*Consolidated Edison Co. v. National Labor Relations Board, supra, National Labor Relations Board v. Columbian, etc. Co., supra, Connecticut L. & P. Co., v. Federal Power Comm., supra*).

The requirement of specific findings as to basic and essential facts as a condition of the exercise of power possessed is of no avail, if inadequate, insufficient or unsupportable fact determinations are so sacrosanct that judicial inquiry is precluded as a "trespass upon the administrative prerogatives (*Colorado-Wyoming Gas Company case, supra*).

"virtually supreme," Congress lawfully may not be excluded from its legislative "prerogatives," even by indirection, and courts of review are not impotent to supervise, examine, modify or set aside administrative determinations as by law directed.[12]

The Court of Appeals, in making its broad generalizations as to the finality of administrative findings, overlooked completely the recent case of *Connecticut L. & P. Co. v. Federal Power Commission*, 324 U.S. 515, 65 S. Ct. 749, in which the decision of this Court was made by a clear majority. In the *Connecticut* case this Court, among other things, launched upon and made an independent review, that is a "re-view," of the facts to test the sufficiency of the evidence, under the standard of "substantial evidence," to support the Commission findings. Certain determinations and conclusions of the Commission were held not tenable, in large part because, as stated by this Court, of the fact to which the Commission apparently gave no weight, "that the predominant characteristics of the company's over-all operation is that of a local and intrastate service." The review there was under *Section 313(b)* of the Federal Power Act, which is identical with *Section 19(b)* of the Natural Gas Act. The decision here is not consistent with the decision there.

Thus the reviewing court, without a true review, lawfully may not make final the fact findings of the Commission. Nor is the judicial determination to be weighted in favor of the Commission so that the reviewing court is compelled to see the problem only through the Commission's "expert" eyes. This the *Connecticut* case discloses.

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[12]Natural Gas Pipeline Co. v. Federal Power Comm., 315 U. S. 575, 62 S. Ct. 736;
Canadian River Gas Co. v. Federal Power Comm., 324 U. S. 581, 65 S. Ct. 829;
Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749;
Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 629, 65 S. Ct. 850.

Regulation of Producing and Gathering of Natural Gas.

The Court of Appeals readily disposed of this very substantial question and with extraordinary brevity. It concluded that, despite *Section 1(b)* of the Gas Act, the Commission had full and *complete regulatory authority* to include petitioner's producing and gathering properties in the Commission rate base. It is said objection thereto "has already been squarely met and conclusively decided" against the petitioner "in the *Colorado Interstate Gas* case," adding that "On certiorari, the Supreme Court, after review and discussion" was of such opinion and so "It is thus clear under the prevailing view the Commission did not exceed its jurisdiction by the inclusion * * *." No attempt or even gesture is made to examine and appraise the legal force and effect of the decision in the *Canadian River Gas Company* case in question.

That Court was unmindful of or unimpressed with the fact that Mr. Justice Douglas, speaking for himself and Justices Black, Murphy and Rutledge only, a minority of this Court, announced the view described by the Court of Appeals as "the prevailing view." Mr. Justice Jackson concurred "in upholding" the Commission action and order but did not concur in the judicial repeal or nullification of *Section 1(b)* of the Act, undertaken by Mr. Justice Douglas and his associates. On the contrary, Mr. Justice Jackson insisted that the Commission by its action had simply taken "evidence as to conditions and events quite beyond its regulatory jurisdiction where they were thought to affect the cost of that whose price it is directed to determine. This as I see it is all that has been done here." This is a plain denial of Commission regulatory authority over production and gathering.[13] The late Mr. Chief Justice Stone, for him-

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[13]The prohibition of *Section 1(b)* of the Gas Act is clear and unambiguous to those seeking to determine and conform to the scope of and the limitations imposed upon the structure of Federal regulatory control embodied therein.

Both the "shall not" and the "shall" provisions of the Act mean precisely what Congress said by the words used. "Shall not" does not mean "shall." "Shall" does not mean "shall not."

self and Justices Roberts, Reed and Frankfurter, declared that the Commission had disregarded "the plain command of *Section 1(b)* excluding the production or gathering of gas" from the regulatory jurisdiction of the Commission. Here then are three views, but no majority of this Court agreed that the Commission had regulatory authority over the producing and gathering of natural gas.

This Court, through Mr. Justice Douglas then speaking for a majority of the Court, recently decided and declared:

In the *Connecticut Light and Power Company* case, supra, the majority of this Court, construing and applying the analogous and virtually identical provisions of the Federal Power Act, and speaking through Mr. Justice Jackson, emphatically repudiated the Commission inversion of the language of the Act.

Referring particularly to *Section 201(b)* of the Power Act, which parallels *Section 1(b)* of the Gas Act, this Court therein declared:

> "It is hard for us to believe that Congress meant us to read 'shall have jurisdiction' where it had carefully written 'but shall not have jurisdiction.' The command 'thou shall not' is usually rendered as to forbid and we think here it was employed without subtlety or contortion and in its usual sense."
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> *Connecticut L. & P. Co. v. Federal Power Comm.*, 324 U. S. 515, 528-529, 65 S. Ct. 749, 755.

"It is hard for us to believe" that Mr. Justice Jackson, who used the foregoing language on one Monday (March 26, 1945) in the *Connecticut L. & P. Company* case, meant,—on the following Monday (April 2, 1945) in the *Canadian River Gas Company* case (324 U. S. 581, 65 S. Ct. 829, 842) by his unambiguous statement "It is true that the Act excludes 'production or gathering of natural gas' from the jurisdiction of the Commission. If the Commission had imposed any direct regulation upon that activity, I would join in holding it to have exceeded its jurisdiction,"—to declare, contrary to the "usual sense" of his words "employed without subtlety or contortion," that the Commission did have "regulatory jurisdiction" over "production or gathering of natural gas." Such conclusion was asserted and announced only by and for the minority for which Mr. Justice Douglas spoke in that case. Nevertheless the Court of Appeals in its opinion herein simply assumed as a fact, but contrary to the fact, that such also was the position of Mr. Justice Jackson. Otherwise there could be no majority and no authoritative decision. Having made the assumption, the Court of Appeals summarily and easily disposed of the jurisdictional issue of "regulation of producing and gathering of natural gas" by reliance upon its own inaccurate catch phrase, "the prevailing view" (*R. V. 3, p. 133*).

"It is hard for us to believe" also, on the basis of fact, of reason and of candor, that on review the statutory provision, "Upon the filing of such transcript such court *shall have* exclusive jurisdiction to affirm, modify or set aside such order in whole or in part" (*Sec. 19(b)*), means that the reviewing court "shall not have" jurisdiction so to do, contrary to the "usual sense" of the statutory language, "employed without subtlety or contortion," declaring expressly the standards of review under the Act. Nevertheless the Court of Appeals so has held herein.

"* * * the lack of an agreement by a majority of the Court on the principles of law involved prevents it (the decision) from being an authoritative determination for other cases" *(United States v. Pink*, 315 U.S. 203, 216, 62 S. Ct. 552, 558).

The divergent minority views expressed in the *Canadian River Gas Company* case, and the force and declared legal effect of such minority expressions of opinion, therefore certainly could not justify the cavalier assertion by the Court of Appeals that the question had been "conclusively decided."

Upon one principle of law this Court, except Mr. Justice Jackson, did agree, however, that the inclusion of the production and gathering properties *in the Commission rate base* constituted the exercise of direct regulatory authority over such properties and not a mere inquiry into and consideration of production costs. *Canadian River Gas Co. v. Federal Power Comm.*, 324 U.S. 581, 597-604, 615-625; 65 S. Ct. 829, 837-840, 845-850). Such determination, therefore, is "authoritative," *(United States v. Pink, supra).*

In any event this Court has not made "an authoritative determination" or "conclusively decided" that the Commission lawfully can include the producing and gathering properties of a "natural gas company" in the Commission "rate base." This issue, the Court of Appeals evaded and did not meet and decide judicially *(R. V. 3, p. 1333).*

Rate Base of Natural Gas Reserves.

The Commission excluded all evidence of "fair value" on the asserted rule of law that "actual cost was accurately ascertainable from the books and records of the Company," and, therefore, it was commanded by *Section 6(a)* of the Natural Gas Act to confine itself to such cost and was prohibited from considering "fair value" for rate base purposes *(R. V. 1, pp. 31-32).* "No such rule of law has been laid down" in the Gas Act or by this Court.

This Court repeatedly has declared, through both majorities and minorities, that "Congress, however, has provided no formula" and "that the Commission was not bound by

the use of any single formula or combination of formulas." No decision of this Court is authority for or even suggests the rule of law imposed by the Commission upon itself that it is directed to fix natural gas rates by exclusive application of the "prudent investment" or "actual legitimate cost" rate base theory.

Federal Power Comm. v. Natural Gas Pipeline Co., 315 U.S. 575, 62 S. Ct. 736;
Federal Power Comm. v. Hope Natural Gas Co., 320 U.S. 591, 64 S. Ct. 281;
Canadian River Gas Co. v. Federal Power Comm., 324 U.S. 581, 65 S. Ct. 829.

The Commission, therefore, "has not proceeded under a correct rule of law" and "it follows" that its order "must be reversed."

Connecticut L. & P. Co. v. Federal Power Comm., 324 U.S. 515, 65 S. Ct. 749.

The Court of Appeals *(R. V. 3, pp. 1329-1333)* ignored entirely this aspect of the legal impropriety of the Commission's action in refusing to consider evidence of "fair value." And whether or not the Commission would have reached the same conclusion as to rate base, aside from such erroneous view of the law, is idle speculation and wholly immaterial *(Connecticut L. & P. Co. v. Federal Power Comm., supra)*. Notice must be taken of the fact that the review sections of the companion Federal Power and Natural Gas Acts are identical. The *Connecticut* case is an "authoritative" command to that Court.

A further consequence of the failure of the Commission to proceed "under a correct rule of law" is that the rigid and "erroneous view of the law," which it did adopt, preclude it "whose duty it is" from making any "pragmatic adjustments" which otherwise might be "called for by the particular circumstances" *(R. V. 3, p. 1339)*.

To consider the facts relevant to the making or withholding of "the pragmatic adjustments which may be called for by particular circumstances" *(Natural Gas Pipeline Company* case, 315 U.S. 575, 586, 62 S. Ct. 736, 743) is one thing. But to hold that the proof of "fair value" *(See Sec.*

6(a) of Gas Act) presented in support of the right to a modification of or substitution for the fixed "cost" rule, as applied to the rate base of natural gas reserves, to satisfy the requirement of a fair and reasonable result, is totally irrelevant, is quite something else. The making of pragmatic adjustments cannot be in the realm of mere administrative benevolence or liberality, as is the established Commission viewpoint. Thereby the disfavored claimant would be without the right even to question in the courts the claimed abuse of "administrative prerogatives." Such a doctrine of administrative finality appears to be that of "absolutism pure and simple." Such is not our structure of government.

Here, whether the correction of the grave injury and injustice to this petitioner, resulting from the application of the "cost" formula to the rate base of the natural gas leaseholds and reserves, is to be made, as directly unlawful or is to be made as a "pragmatic adjustment called for by the particular circumstances" to avoid an "arbitrary result," in any event the Commission has abused and exceeded its authority and discretion. The "end result" in this case of the Commission "cost" formula is grossly unfair, unsupportable and irrational. It is arbitrary and capricious by every standard.

The Commission conclusion or so-called "finding" that its "cost" rate base was "reasonable" *(R. V. 1, p. 50)* is mere words. If, as the Commission erroneously assumed, it was required by law to use and only to use "cost," there remained no area of discretion whatever as to whether the rigid cost formula was "just and reasonable" or "arbitrary." The Commission thus did not permit itself to consider any facts and circumstances other than "cost" and so there could be but one "end result." Such is not the law, as any real examination of the recent decisions of the Supreme Court above referred to will disclose.

The Court of Appeals *(R. V. 3, pp. 1332-1333)*, in its appraisal of the *Canadian River Gas Company* case (324 U.S. 581) upon the issue of the legality of including the gas-producing properties of that Company in the rate base "at their nominal cost" to the total exclusion of the con-

cept and fact of the "value" thereof, stated: "That point was taken on certiorari, 323 U.S. 807, and specifically treated on appeal, 324 U.S. 604. The majority of the Court could not 'say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost.'" Such is not the case. The facts, which cannot be stilled, are that no "majority" approved the statement herein attributed to it. That statement reflected the views of four Justices only. The concurrence by Mr. Justice Jackson in affirming the Commission order cannot possibly be twisted into approval or acceptance of the Douglas-Black-Murphy-Rutledge theory. The views of Mr. Justice Jackson were emphatic and divergent from and hostile to the stated concept of Mr. Justice Douglas, both on principles of law and morality, as were the conclusions of the remaining four Justices.

Moreover, the language quoted by the Court of Appeals *(R. V. 3, pp. 1332-1333)* is but a part of what was said by Mr. Justice Douglas upon the precise question here under discussion, and as a part only it is misleading. As quoted, it carries a conclusion definitely inconsistent with what was said by the Justice, which was:

> "Hence, we cannot say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost. *That could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case.*" (324 U.S. at p. 604.)

The emphasized portion of the foregoing paragraph was omitted from the quote by the Court of Appeals. In its absence that Court concluded "In view of these pronouncements, we regard the question no longer a debatable one in this court" *(R. V. 3, p. 1333)*.

The paragraph must be examined in its entirety. Obviously the second sentence is the explanation of the "why" of the first sentence. The "why" is that this Court could not decide the question at all, because of the limited review granted in the *Canadian* case.

The assertion of the Court of Appeals that the question was decided in the *Canadian* case and adversely to the contention of this petitioner, thus is without foundation.

That Court, in its effort to justify the Commission in exercising the power of decision untrammeled by judicial interference or "notions" *(R. V. 3, p. 1327)* presents the views of Justices Murphy, Black and Douglas *(Natural Gas Pipeline Company* case, 315 U.S. 575, 606) to the effect that "the economic merits of a rate base is of no judicial concern" *(R. V. 3, p. 1332)*.

The opinion in question was one of special concurrence and was not a decision of this Court. The three Judges, in developing their thesis, cited with approval the definition of Mr. Justice Brandeis in *Missouri, ex rel. S.W. Bell Tel. Co. v. Public Service Commission,* 262 U.S. 291, 43 S. Ct. 547, to the effect that the investor interest is adequately served if the utility is allowed the opportunity to earn the cost of the service. That cost was defined by Mr. Justice Brandeis, as follows:

> "Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor, the allowance for risk incurred, and enough more to attract capital * * *."

Such are the criteria of judgment of the jurist whose pronouncements were relied upon, as well as the requirements of the Natural Gas Act.

Mr. Justice Brandeis fully recognized these investor interests and rights, and insisted that they be protected. They are economic in nature. How else could they be classified?

Thus, when the Court of Appeals declared it has "no judicial concern" with "the economic merits of a rate base," which means that a clear property right is to be totally discarded, it amounts to a categorical abjuring of the very function that Court is expected and required to perform. It is basic that the reviewing court remains free to draw the ultimate conclusion dictated by reason and logic. Any real test of due process is a test of reasonableness.

The statutory command directed to the Commission is to determine the "just and reasonable rate," that is, "just and reasonable" to consumer and investor alike *(Secs. 4(a) and 4(e), Gas Act)*. On review and in conformity with the standard of the Act, the reviewing Court likewise is directed to register its independent judgment as to the propriety of the Commission conclusion of "just and reasonable" and of "the facts" upon which that conclusion is predicated. Otherwise, the right of review is a mere prefunctory validation of the Commission's order.

So, it is the inescapable duty of the reviewing court to determine whether it is consonant with fair and reasonable action to exclude as a matter of law from the adjudication of justness and reasonableness enjoined by the statute, *all* consideration of the very great value admittedly inherent in the natural gas leasehold estates herein involved.

Such leaseholds of petitioner, to all intents and purposes, are eliminated from the property account under the Commission "cost" theory. No such result was contemplated by Mr. Justice Brandeis, when he declared that the use of capital must be compensated, and likewise the risk incurred, and enough more to attract capital.

"Devaluation," brought about by the non-reviewable elimination of an essential right of property from the allowance of compensation, obviously is in opposition to the requirement of constitutional due process that a fair opportunity be given for submitting the issue to a judicial tribunal for its independent judgment and determination.

Nowhere in the opinion of the Court of Appeals is there to be found a conclusion or expression of view on the subject of justness and reasonableness. That is to say it does not appear from the opinion whether that Court was convinced that there is actual and sufficient support in fact, in reason and in fairness for the elimination and destruction of the very great and valuable property rights involved *(R. V. 3, p. 1331)*. The Commission result is permitted to prevail because of the abounding and conclusive presumptions which that Court erects to obstruct its own judicial path. Such

presumptions sanction any imaginable action that the Commission might choose to indulge.

The dogma that courts are not concerned with the economics of a rate base cannot be carried to the length that a clear right of property may be expropriated because a mere question of economics is involved. The injunction of the Act to the courts equally with that to the Commission is to so discharge its functions that the result is fair and reasonable to consumer and investor alike.

The Court of Appeals *(R. V. 3, p. 1333)* in conclusion complained that "petitioner has offered no evidence from which we would be justified in concluding that the failure of the Commission to base the allowable return upon the fair value of the leaseholds"—or even to consider the fair value of such leaseholds—"results in the impairment of the financial integrity of the company as a public utility."

The viewpoint of that Court obviously was that it was immaterial whether "the reasonable rate base" *finding* of the Commission was supported by the evidence or fair and reasonable because the burden in the hearing before the Commission and throughout the case was on petitioner to establish by evidence that the Commission determination was unfair, unreasonable and arbitrary.

It is asked how, under the rigid and erroneous rule of law adopted by the Commission, could the question of "impairment" be material or evidence thereof be admissible at all? Moreover, how could it be determined whether there had been or had not been such "impairment" without evidence and knowledge of values? Also, since the Commission action and the disposition therein of the manifold matters of fact and questions of law could not be known until after the close of the case and the entry of its order of rate reduction, just how could this petitioner thereafter offer evidence of "impairment" and secure the incorporation thereof in the record herein? These questions pose problems which, in view of its complaint, that Court of necessity should have faced, but which it did not face or apparently even apprehend.

The law, as declared by this Court is:

"Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the *pragmatic adjustments which may be called for by particular circumstances.* Once a fair hearing has been given, *proper findings made* and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been over-stepped. *If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.*" (Emphasis added.)

Federal Power Comm. v. Natural Gas Pipeline Co., 315 U.S. 575, 586, 62 S. Ct. 736, 743.

Neither the Commission nor the Court of Appeals evidenced regard for or adherence to this rule of law, presently controlling. The Commission, after declaring its incapacity to do otherwise *(R. V. 1, pp. 31-32)*, nevertheless made the futile gesture of an "ultimate finding" that its rigid cost rate base was "reasonable" *(R. V. 1, p. 50)*. That was the end of the matter so far as the Commission was concerned. The Court of Appeals attempted to dispose of the matter on the ground that, unless "it is conclusively shown" that the Commission order does destroy the petitioner, there is no basis whatever for relief *(R. V. 3, p. 1332)*. This is not the law. It is not fair. It is not decent. It is, therefore, arbitrary. That which is fair, reasonable and decent, as contrasted with that which is arbitrary, easily is measured by resort to the spirit and structure of our society and the "common sense of mankind."

The application of the Commission "cost" theory of rate base to the natural gas rights and leaseholds of this petitioner produces weird, wild, fantastic, illogical, senseless, unfair and totally arbitrary results.

Natural gas produced by petitioner does not enter into the Commission computations either at value, field price, or as a commodity at all. It was not treated *in any respect* the same as purchased gas, *simply because petitioner produced it.*

The Commission "cost" theory produced the following amazing consequences *with respect to current production and deliveries* of gas by petitioner to its customers in 1941:

$.048 per M.c.f. was the current open field price of purchased gas by petitioner in 1941. This price included cost of production, depletion, depreciation and return.

$.02 per M.c.f. ($.0202 per M.c.f. less $.00201 per M.c.f.) was the total production "cost" to petitioner *excluding return on gas reserves,* of all produced gas in the same year.

Nothing, except expense of production, was allowed for gas produced from two-thirds of petitioner's productive reserves in the Texas Panhandle field (28,081,742 M.c.f.). Thus this gas is given away.

$.0023 per M.c.f., plus expense of production, was allowed for gas produced from the remaining one-third of petitioner's productive reserves in that field (14,040,871 M.c.f.).

$.031 per M.c.f., plus expense of production, was allowed for gas produced in the expiring Kansas and Oklahoma fields (1,029,157 M.c.f.).

$.00201 per M.c.f., plus expense of production, was the average allowance for all gas produced and delivered by petitioner in that year.

With respect to the Commission "cost" rate base the results equally are inexplicable:

$.00028 per M.c.f. for the vast gas reserves in the Texas Panhandle and Hugoton fields (3,455,882,921 M.c.f.).

$.114 per M.c.f. ($.10427 per M.c.f., as depleted by the Commission) for the then expiring reserves in the other Kansas-Oklahoma fields (4,794,964 M.c.f.).

See dissenting opinion, Judge Phillips *(R. V. 3, pp. 1342-1346)*, Summary Statement, *supra.*

The foregoing figures manifest beyond peradventure the utter inapplicability of the Commission "cost" theory to the annual production and rate base of natural gas reserves. The fixation of rate base on the criterion of nominal cost of natural gas rights and leases is unreasonable and arbitrary.

The Court of Appeals avoided comment and decision upon these nonsensical and illogical results by disclaiming any "judicial concern" in what it described as "the economic merits of a rate base." The foundation of this disclaimer is not the law. Under any and every accepted standard of thinking and reason, the result is in fact arbitrary. That which is not reasonable is arbitrary. If the Commission result here is not arbitrary, it is impossible to conjure up circumstances under which its action could be found to be arbitrary.

Under the views of that Court, every Commission conclusion is so protected by presumption piled on presumption that it is final if not so wide of the mark as to be irrational as well as arbitrary. Such dogma means that the result of the statutory review, notwithstanding the standard of "substantial evidence" and notwithstanding the requirement that on the facts the Commission order "produces no arbitrary result," is precisely the same as if there were no right of review of any kind.

Existing Depreciation and Depletion.

Aside from the theoretical and argumentative assertions and conclusions as to facts and law which the Commission as a matter of uniform practice incorporates in its opinions in rate cases to justify its practice of treating "depreciation and depletion" as essentially a matter of mere accounting, the findings of purported "facts" are limited substantially to the following mixture of fact and conclusion reciting the supposed "informed judgment" of the Commission and its staff witness on the subject:

> "The Commission's staff presented a complete depreciation and depletion reserve requirement study, i.e., a computation of the reserves which should have been accrued had the Company properly recorded in reserves the accumulated cost of the property consumed in service. *A qualified staff engineer inspected the Company's properties,* analyzed its past experience and that of its predecessors, and estimated the over-all service lives of the property by classes. *He considered* service life data on other pipe lines, *and treated realistically both the physical*

and functional aspects of depreciation." (Emphasis added.)

(R. V. 1, p. 44.)

As a part of the foregoing, the Commission naturally found it necessary to find that "A qualified staff engineer inspected the Company's properties * * *." Such inspection was basic and essential *(R. V. 1, pp. 428, 430)* in the prepation of a "realistic" depreciation, depletion and service life exhibit to guide the Commission. The Commission in fact adopted and followed the Commission staff exhibit *(Comm. Ex. 15, R. V. 3, pp. 1127-1142)* thus prepared and offered in evidence *(R. V. 1, pp. 43-45)*. But it developed, as is now admitted *(R. V. 3, p. 1335)*, that the sole Commission staff witness on the subject of depreciation and service lives did not make a single inspection of any part of the pipeline system of the petitioner *(R. V. 1, pp. 450-451)*. The pipeline system of more than 4300 miles admittedly constitutes more than 70% of the Commission total "actual legitimate cost" of all facilities *(R. V. 3, Comm. Ex. 5, pp. 977-978; R. V. 1, p. 50)*. The witness testified that he made "field inspections of the Company's property * * * to observe" physical and functional depreciation *(Comm. Ex. 15, R. V. 3, pp. 1127-1128)*. The Commission also found that "he * * * treated realistically both the physical and functional aspects of depreciation." Thus, the Commission finding asserts a personal knowledge and an "informed judgment" which the witness admitted he did not possess. The fact is the witness did not inspect the pipeline system or any part of it. This fact cannot be obscured or dissolved by edict, administrative or judicial. The finding of the Commission to the contrary is not "supported by substantial evidence" or any evidence, but is directly contradicted by the Commission witness himself. Thus the Commission did not address itself to the evidence, which is its basic duty. Failure so to do is error as a matter of law.

On this state of the record, the Court of Appeals undertook to substitute for the discredited finding a finding of its own, to the effect that the witness was excused from making such inspection, and thereby receiving direct personal knowledge of "the physical and functional aspects of depreciа-

tion," in that "he was prevented from doing so by the refusal of the petitioner to dig the 'bell holes' and that instead his inspection of the retired pipe, and his examination of the Company's inspection reports, enabled him to form a reliable opinion concerning the average service life of this particular class of property" *(R. V. 3, pp. 1334-1335)*. *The Commission, of course, made no such finding (R. V. 1, pp. 43-45)*. Aside from the inaccuracy of the substitute finding *(R. V. 1, pp. 438-439, 489; Pet. Br. pp. 79, 81, 82; Pet. Rep. Br. pp. 31-47)*, this Court is not permitted to make a finding and substitute it for that of the Commission.

> "*The courts cannot perform the function which Congress assigned to them in absence of adequate findings. Nor are they authorized under §19(b) to make findings and substitute them for those of the Commission.*" (Emphasis added.)
>
> *Colorado-Wyoming Gas Co. v. Federal Power Comm.*, 324 U.S. 626, 634, 65 S. Ct. 850, 854.

The Court of Appeals *(R. V. 3, p. 1335)* ignored the fact that even if "the petitioner offered no evidence concerning the economic service life or depreciation rates, and as against its objections" to the insufficiency of the evidence of the Commission "staff witness," it does not follow, as stated, that the reviewing court "must conclude that the evidence is sufficient to support the Commission's ultimate findings and conclusions." The statutory standard that "the finding of the Commission as to the facts" must be "supported by substantial evidence" may not be rejected at will or at all by the courts. That, the Court of Appeals has done here. That Court heretofore has recognized and declared that "in the absence of substantial evidence" the action of the Commission is "the arbitrary exercise of power by administrative fiat and cannot stand" *(Colorado Interstate Gas Co. v. Federal Power Comm.*, 142 Fed. (2d) 943, 954). Moreover, on the "hearing" before the Commission, the burden of proof is on that body *(Public Service Comm. v. Colorado-Wyoming Gas Co.* (F.P.C.), 43 P.U.R. (n.s.) 205, 231; *Colorado Interstate Gas Co. v. Federal Power Comm., supra*, at page 954). Yet here that same Court has held that, since the petitioner did not deem it necessary to offer

counter-evidence on the issue under consideration, the Court *(R. V. 3, p. 1335)* "must" sustain "the Commission's ultimate findings and conclusions" without regard to whether or not such "findings and conclusions" were "supported by substantial evidence." Such a rationalization has no support whatever in law. Since the Court of Appeals "considered irrelevant" the statutory standard of *Section 19(b)* "the inquiry on review has not proceeded under a correct rule of law and it follows that the judgment of the Court of Appeals must be reversed" *(Connecticut L. & P. Co. v. Federal Power Comm.*, 324 U.S. 515, 532, 65 S. Ct. 749, 757).

As illustrating the disregard of the record by both Commission and Court of Appeals, the Commission, by "adjustment," added to the "depreciation reserve" of petitioner an item of $2,200,000 accumulated by a non-affiliate predecessor company, Kansas City Pipe Line Company, as "bond amortization" for the years 1908 to 1912 *(R. V. 1, pp. 39-40)*.

The Commission accounting witness who made the adjustment in question testified on direct examination:

> "From about *1908 to 1912* Kansas City Pipe Line Company had set up reserve for depreciation in the amount of $2,200,000. *This reserve was the result of receiving from Kansas Natural Gas Company as part of the rental for its line, an amount during those years equal to the bonds redeemed.* These amounts were included as rental in the accounts of Kansas Natural Gas Company.
>
> • • • • •
>
> "Q. In other words, from the records you determined the actual cost of that property (Kansas City Pipe Line Company) to be $3,893,031.58?
>
> "A. That is correct. Likewise Kansas Natural Gas Company failed to reflect in its records the accrued depreciation set up on the books of Kansas City Pipe Line Company ($2,200,000) *and this amount I have included in my record as an adjustment to the reserve for depreciation of gas plant in service.*" (Emphasis added.)
>
> *(R. V. 1, pp. 207-208)*.

In short, a reserve for "bond amortization" from 1908 to 1912 simply is appropriated and by "adjustment" translated

into "reserve for depreciation of gas plant." In this fashion, the round sum of $2,200,000 depreciation is accumulated in four years on property, the actual cost of which the Commission witness declared to be $3,893,031.58, including non-depreciables. This then is the wholly insufficient record upon which the Commission relies to justify the $2,200,000 "adjustment" of petitioner's depreciation reserve, of which we complain. This is arbitrary action. The Court of Appeals ignored this issue *(R. V. 3, pp. 1333-1335)*.

Natural Gasoline Operations of the Cities Service Oil Company.

The issue here presented is whether the Commission acted unlawfully in segregating the natural gasoline extraction plants of Cities Service Oil Company from the other properties of the Oil Company and treating such plants and the operation thereof "as if they belonged to petitioner" *(R. V. 3, p. 1336)*. This was done solely in reliance on the fact that the two companies are affiliates, in that the common stocks (not outstanding securities) of both are owned by Empire Gas and Fuel Company (Delaware). The two companies are separate in operation and from the beginning of *all* gasoline extraction operations in 1918 the plants and business of such extraction have been exclusively the properties of Cities Service *Oil* Company *(R. V. 3, pp. 1033, 1037)*. There is no evidence in the record that the gasoline extraction operations of the *Oil* Company herein involved are now, or were at any time, in fact or in law, the operations of this, the *Gas* Company, but carried on by it through the corporate structure of the Oil Company.

The Court of Appeals approved the Commission action on the false premise that "otherwise, a regulated gas utility would be permitted to syphon off its profits to affiliates through the guise of contracts * * *." It is said "If the extraction process is in reality an essential part of the business of transporting and marketing the natural gas, the Commission was justified in ignoring the contract between the two affiliates for the purpose of determining just and reasonable rates" *(R. V. 3, p. 1336)*. Apparently by this language the Court intended to approve the take-over of the *Oil* Company property and the assumption of complete rate-

regulatory authority over its properties and business in question. The *Oil* Company was not allowed even Federal income taxes on the 6½ per cent return allowed it by the Commission *(R. V. 2, pp. 805, 806, R. V. 3, p. 1021)*. As to this action the Court of Appeals is silent.

Concededly, the Commission in a rate case may inquire into the reasonableness of contracts between a "natural gas company" and an affiliate such as Cities Service *Oil* Company which is not a "natural gas company." If the contractual relation is not reasonable, the Commission properly may require appropriate adjustment thereof. Such procedure is standard practice. But the Oil Company "is to be treated as a segregated enterprise" even though the affiliate relation "may demand close scrutiny" *(Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 144, 151-153, 51 S. Ct. 65, 67, 70).

See, dissenting opinion Judge Phillips *(R. V. 3, pp. 1347-1349)*.

The record facts are:

The natural gasoline extraction or processing plants of Cities Service *Oil* Company presently involved herein are situate at Wichita, Kansas, and Tallant, Oklahoma *(R. V. 2, pp. 787-788)*. The Wichita plant, which extracts natural gasoline from natural gas produced by petitioner in the Texas Panhandle field (being 47,392,302 M.c.f. in 1941, which amounted to 40% of petitioner's total deliveries of 117,459,914 M.c.f. in that year) *(Comm. Ex. 14, Sch. 1, R. V. 3, p. 1119)* is in excess of 250 miles from the Panhandle field. Between the field and Wichita that natural gas passes through five compressor stations *(Map, Comm. Ex. 14, R. V. 3, p. 1125)*. The Tallant plant extracts natural gasoline from natural gas purchased and produced in several Oklahoma fields which are located as much as 150 miles distant from such plant. Enroute to the Tallant plant, that gas passes through one compressor station *(Map, supra)*. The Wichita plant is much larger than the Tallant plant *(Comm. Ex. 11, Sch. 6, R. V. 3, p. 1031)* and produces 90% of the revenue here under consideration *(Comm. Ex. 11, Sch. 2, R. V. 3, p. 1023)*.

The Commission made a general "finding": "This operation is profitable and renders the natural gas more readily marketable and transportable. The extraction of gasoline and other residuals reduces the heat content and consumes a certain volume of the natural gas" *(R. V. 1, p. 53)*.

The sole witness for the Commission on this subject testified generally on direct examination that the extraction of gasoline and other residuals from natural gas is a necessary function of the business of transporting and delivering natural gas; gasoline and other residuals so extracted from natural gas are by-products of the pipeline business because the extraction of residuals from natural gas is essential to the transportation and sale of natural gas, and that natural gas, to be merchantable or suitable for commercial use, must be dry or free of moisture *(R. V. 2, p. 770)*.

This testimony, it will be observed, is not directed at all to the particular processing operations of the Cities Service *Oil* Company at its Wichita and Tallant plants, but is simply a broad conclusion as to the functions of natural gasoline extraction plants *in general*. This *only* engineering witness of the Commission did not present any facts or expert conclusions to afford any basis whatever for the Commission so-called finding quoted, *supra*. However, on cross-examination, he was forced to admit that much of the natural gas handled by petitioner was not treated for gasoline extraction; that the natural gas which was so treated traveled hundreds of miles before such treatment; that in fact whether natural gas was so treated by this petitioner was not dependent upon the fact of production or of purchase; and that the controlling and decisive consideration was whether or not there was sufficient gasoline content in the gas to make commercial operations profitable *(R. V. 2, pp. 773-774)*. The only evidence in the record, *and that is uncontradicted*, is: "The fact in this case is that the gasoline plants at Wichita and Tallant remove gasoline which could have been left in without harm to either the usefulness of the gas or its suitability for transportation." The same witness added that it was obvious that the removal of the gasoline from the natural gas at Wichita and Tallant plants is not required to facili-

tate the transmission of that gas, for "that gas had traveled hundreds of miles before it got to those plants" *(Miller, R. V. 2, pp. 775, 776)*. So the factual assumptions so easily indulged by the Commission *(R. V. 1, p. 53)*, unrelated as they are to the processing operations of this petitioner's gas, are not supported by and are contrary to the record. There is *no evidence* as to *amount* of natural gas consumed in the process or the reduction in heating value and the effect thereof, of which both Commission and its counsel talk.

The Commission accounting witness testified: "We acted as though one company carried on the entire transaction"; "I haven't attempted to make any adjustment in the price. I have taken an adjustment of the total earnings" *(R. V. 2, pp. 792, 802)*.

Thus the Commission, following the staff exhibit *(Comm. Ex. 11, R. V. 3, pp. 1019-1037)* deliberately expropriated the extraction plants, business and earnings of Cities Service *Oil* Company and made a collateral but complete rate case determination with respect to that business, in this case, in the absence of the *Oil* Company, and precisely as though the Oil Company were a "natural gas company subject to Commission rate-regulatory authority under the Gas Act."

The Court of Appeals attempted, however, by an inaccurate recital of the direct testimony of the Commission "staff witness" to justify the Commission action here, under "the theory" of *Cleveland v. Hope Natural Gas Company*, 44 P.U.R. (n.s.) 1, 27-28, where there were specific findings that "the extraction of gasoline and butane * * * is necessary to make the natural gas marketable and transportable," and "It is significant that Hope Natural Gas Company processed its own gas before 1920." Neither before the Commission nor on review *(Hope Natural Gas Co. v. Federal Power Comm.*, 134 Fed. (2d) 287, 307) did the Company raise any issue as to the propriety of such Commission action.

In this case, however, the "staff witness" in question did not testify that natural gasoline extraction "was a necessary function of" Cities Service Gas Company or that "such

process was essential to the transportation and sale of the natural gas" of this petitioner, or that the extraction process was "in reality" a part of this petitioner's business. *Moreover, the Commission made no such findings (R. V. 1, p. 53).* Here again then the Court *(R. V. 3, p. 1336)* has undertaken "to make findings and substitute them for those of the Commission," which, as we have seen, *supra,* it is not authorized to do.

The obvious assumption of this Court also is that the statutory standard of "substantial evidence" is met and satisfied by seizing upon some generalization of a witness which is without application to the particular case and without support of and contrary to *the known and uncontroverted facts.* Neither the Commission nor the reviewing court may so proceed. The entire record controls and must be examined and appraised *(Connecticut L. & P. Co. v. Federal Power Comm.,* 324 U.S. 515, 521, 534, 65 S. Ct. 749, 752, 758).[11]

Here then is action, arbitrary in fact and in law, to which the Court of Appeals has given its approval and affirmation.

Federal Income Taxes.

The essential facts and issues involved in this discussion have been quite fully detailed and presented in the foregoing petition for review, under the subject titles, "Questions Presented," "Summary Statement of Matter," and "Reasons for Granting the Writ," *supra.*

It is necessary here, therefore, to comment but briefly upon the impropriety and illegality of the Commission action *(R. V. 1, p. 57)* and the approval thereof by the Court of Appeals *(R. V. 3, p. 1337).*

The Court of Appeals *(R. V. 3, p. 1337)* made the amazing statement "* * * the Commission was certainly justified in refusing to allow the item as an expense, *because if it had permitted the item to remain in the total cost of service before allocation, it would have been justified in allocating the entire amount to the jurisdictional sales."* This declaration is an obvious *non-sequitur* and "a straw man" as well. The

idea that the Federal Power Commission conceivably would do that which that Court suggests as a danger is so fanciful as to merit no reply. As to the logic of the conclusion, it no more follows that Federal income taxes as an allocable item would or properly could be allocated entirely to "the jurisdictional sales" than any other item of allocable expense. As to either type of expense item, the Commission would not be "justified" in so allocating it, and its action, if it did so, would be just as arbitrary in fact and in law as is its equally extreme action here "in allocating the entire amount" of Federal income taxes to "the non-regulable sales."

Here again, as in previous subdivisions of its opinion, the Court of Appeals *(R. V. 3, p. 1337)* sought to buttress its conclusion by complaint that the petitioner "offers no affirmative computation tending to show its tax liability upon the permissible rate" and so "*we must assume* that the Commission statement * * * is correct" that it "did no more than allocate to the non-jurisdictional sales the cost of earnings which were solely attributable to it," (purely a conclusion of law) and, therefore, "it was legally justified in eliminating the Federal income tax liability as an item of cost." This argument of that Court evidences a complete misapprehension of the record as well as the law. The law is clear. There is no issue of fact. The issue is one of law. And as we have shown, neither the Commission nor the Court of Appeals has proceeded under a correct rule of law in this matter.

The error of law is made more abundantly clear by reference to the Commission brief herein before the Court of Appeals *(pp. 39-40)*, where it is said: "*If* all of petitioner's rates were subject to regulation and petitioner had been limited to an over-all fair return of 6½%, it would not have paid any Federal income taxes." This, counsel for the Commission state as the Commission "thesis." It is entirely hypothetical and supposititious. Let us apply the law to it: "If all of petitioner's rates"—*both regulable and non-regulable*—"were subject to regulation"—*which they are not*—"and petitioner had been limited to an over-all"—*regulable and non-regulable business*—fair return of 6½%—*which is*

beyond the authority of the Commission according to both the Gas Act and this Court—"it would not have paid any Federal income taxes." Nevertheless, and despite the law to the contrary, the Commission proceeded to dispose of Federal income taxes precisely as though its hypothetical "thesis" were in conformity with law.

> See dissenting opinion, Judge Phillips *(R. V. 3, p. 1349)*.

The fundamental misconception of the Court of Appeals *(R. V. 3, p. 1337)* was that Federal income taxes attributed by the Commission to the earnings of "the non-regulable sales" in excess of 6½% could not be "allowed as an expense" because, as the Court of Appeals erroneously *(Colorado Interstate Gas Co. v. Federal Power Comm.*, 324 U.S. 581, 588, 65 S. Ct., 829, 833) assumed, petitioner *"cannot lawfully earn"* more than 6½ percent upon "the non-regulable sales."

> See *Galveston Electric Co. v. Galveston*, 258 U.S. 388, 399, 42 S. Ct. 351, 356.

Since neither Commission nor Court of Appeals has proceeded under a correct rule of law, the order of the Commission and the judgment of the Court must be reversed *(Connecticut L. & P. Co. v. Federal Power Comm., supra)*.

Allocation of Cost of Service.

The treatment by the Court of Appeals of this subject is peculiarly inept. It is epitomized by that Court's declaration *(R. V. 3, p. 1339)* that "We shall not criticize that which we are powerless to correct." This statement leads us to observe that there are none so powerless as those who reject the very power they possess.

It is said also *(R. V. 3, p. 1339)* that "The appropriateness of the formula raises questions of fact, not of law," that "allocations 'require the exercise of *informed judgment* and use of procedures which appear to be *reasonable*' " in each case, that "If some of the specific allocations appear to be *illogical and unfair*, they necessarily pose *technological problems* of accounting and finance upon which the *admin-*

istrative judgment has been declared *virtually supreme*" and finally that "*If* allocation of cost of service is a fundamentally correct and permissible method * * * we cannot say on the record that the application of the formula *is so wholly unrelated to the facts* as to produce an illegal or reversible error." These statements taken together all add up to the proposition that the Commission conclusion that "the staff's method as applied was fair and reasonable" *(R. V. 1, p. 61)* is final, supreme and not subject to review under *Section 19(b)* of the Act. Accordingly, the reviewing court cannot make any independent determination as to whether the Commission addressed itself to the evidence or whether its determination was "reasonable" or "illogical and unfair" and, therefore, arbitrary.

Under such a view the Court of Appeals, as the statutory court of review, is prevented and prohibited from any determination whatever (adopting the language of Mr. Justice Douglas), of whether the Commission in the required "separation of the regulated and unregulated business" has "assigned" *in fact* any part of "the profits or losses, as the case may be, of the unregulated business * * * to the regulated business" and thus has proceeded to "transgress the jurisdictional lines which Congress wrote into the Act" *(Panhandle Eastern Pipe Line Co. v. Federal Power Comm.,* 324 U.S. 635, 641-642, 65 S. Ct. 821, 825). The Commission determination of this issue being, so it is said, "the exercise of informed judgment," and predicated upon "technological problems," the Commission becomes a law unto itself. Such is the ruling of the Court of Appeals. This is "illegal and reversible error."

This Court, speaking through Mr. Justice Douglas in the *Colorado Interstate Gas Company* case (324 U.S. 581, 589, 590, 591, 65 S. Ct. 829, 833, 834), declared:

> "* * * Congress indeed prescribed no formula for determining how the interstate wholesale business, whose rates are regulated, should be segregated from the other phases of the business whose rates are not regulated. * * * But we cannot say that under the Natural Gas Act the Commission can employ only one allocation formula and that that formula must entail a segregation of prop-

erty. * * * Allocation of costs is not a matter of the slide rule. It involves judgment on a myriad of facts. * * * *Under this Act the appropriateness of the formula employed by the Commission in a given case raises questions of fact not of law.* .* * *

* * * * *

"* * * Considerations of fairness, not mere mathematics, govern the allocation of costs."

As was also stated by Mr. Justice Douglas, speaking for this Court, in the *Panhandle Eastern Pipe Line Company* case (324 U.S. 635, 641-642, 65 S. Ct. 821, 825):

"We agree that the Commission must make a separation of the regulated and unregulated business when it fixes the interstate wholesale rates of a company whose activities embrace both. Otherwise, the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act."

The question presented then in each case, where allocation is necessary, is whether there must be a "formal allocation" or a so-called "cost of service allocation" will suffice. Neither Commission *(R. V. 1, p. 59)*, nor Court of Appeals *(R. V. 3, pp. 1337-1339)* gave any consideration whatever to this question. Without either findings or attention to "considerations of fairness," it was *assumed* by the Commission that "the staff's method as applied was fair and reasonable" and "we * * * adopt it for the purpose of this proceeding" *(R. V. 1, p. 61)*. The Commission in fact departed both in method and in detail from the "cost of service" allocation of its staff *(Comm. Ex. 30, R. V. 3, pp. 1187-1213)*. It did not make reference to it in its opinion for purposes of reconciliation or otherwise *(R. V. 1, p. 61)*, where it is said by way of ultimate conclusion:

"We have allowed for expenses and return a total of $10,967,041. Rents and other miscellaneous gas revenues, totaling $121,782, should be credited thereto, leaving $10,845,259 as the total cost of service. Applying the staff's method of allocation, we find that $7,264,986 represents

the total cost of service (including a fair return) for the sales subject to our jurisdiction, and $3,580,273 represents the cost of service for the sales not subject to our jurisdiction."

(R. V. 1, p. 61).

It was declared by Mr. Justice Douglas, in *Colorado Interstate Gas Company* case (324 U.S. at 595, 65 S. Ct. at 836), referring to the alleged vagueness of the findings of the Commission on the "allocation of costs," of service, "The findings * * * leave much to be desired since they are quite summary * * *. But the path which it followed can be discerned."

In the *Colorado-Wyoming Gas Company* case (324 U.S. 626, 635, 65 S. Ct. 850, 854), on the other hand, the Commission having made some departure from the staff method, the case was reversed and sent back to the Commission for proper and disclosing findings.

In that case the late Chief Justice Stone, Mr. Justice Roberts, Mr. Justice Reed and Mr. Justice Frankfurter were of the opinion "that the case should be remanded to the Commission for separate allocation of investment and operating cost between the regulable and non-regulable properties, as well as for the clarification of findings directed in the opinion."

Certainly, under the authority of this Court, both the character and the substance of the allocation is a procedure of major importance, and because it is so subject to the likelihood or possibility of abuse, Commission action in that behalf must be carefully examined and considered in each case by the reviewing court to insure that the Commission does not "transgress the jurisdictional lines which Congress wrote into the Act."

In this case, what is the "path" which must be "discerned" from "the findings"? How is that "path" disclosed?

The foregoing "findings and conclusion" of the Commission in this case tell us where the Commission *declared it started* and next tell us the final result, which it is said

attains "all that can be accomplished by an allocation of physical properties." Obviously, an allocation of physical properties would disclose the portions of the property, described either in terms of percentages or of dollars, allocated to the regulated operations and to the unregulated operations, respectively, and the actual amount of return apportioned to the jurisdictional and non-jurisdictional operations.

Yet it is significant that there is no Commission finding *(R. V. 1, pp. 59-61)* or other disclosure in the entire record either in percentages or in dollars, showing the property and return allocated to each class of the business, that is, to the regulated property and business and to the unregulated property and business. This part of "the path" is completely obscured.

Consequently, it is impossible to determine or even examine into, the question of whether the ordered reduction in the rates and charges of the regulated part of the enterprise produces an arbitrary result, with respect to the *undisclosed* portion of the property, business and earnings which the Commission, by its "method," purports to allocate to the regulated business. And certainly the test of financial stability declared by Mr. Justice Douglas as a measure of the reasonableness or unreasonableness of the "end result" of the rate reduction order cannot be applied in the absence of some actual separation in dollars or percentages in the property and earnings of the regulated and unregulated operations.

It cannot be denied that "allocation" reaches the very heart of and directly and substantially controls the amount of the ordered reduction. It is obvious that the Commission processes and procedures can be and have been altered, in this and in other cases, at will and without explanation as to the controlling considerations of law and fairness substantially to effect the amount of the rate reduction order.

The Commission treatment of "Federal income taxes" and of the alleged "excess earnings" from the natural gas extraction operations are illustrative of the unlimited range of "discretion" exercised by the Commission in its "allocation" processes.

The Commission staff witness *Orme*, who prepared and presented *(R. V. 1, p. 811)* the Commission Exhibit 30, entitled "*Cost of Service and Allocation of Cost of Service*" *(R. V. 3, pp. 1187--1213)*, testified that he had never before prepared such "a cost allocation" *(R. V. 1, p. 825)*. Nevertheless, he proceeded to sort out, classify and apportion expenses as between "Commodity Costs" and "Demand Costs," as he defined them *(R. V. 1, p. 819)*, without any factual or other explanation whatever as to the basis of the classification and apportionment of such "Costs" embodied by him in the exhibit in question *(R. V. 3, pp. 1201-1211)*. Such is the "staff's method" which the Commission concluded was "fair and reasonable" *(R. V. 1, p. 61)*. The open end and uncontrolled character of the "Cost of Service Allocation" so prepared by the witness is illustrated by the following testimony given by him:

> "*Such allocations require the exercise of informed judgment and the use of procedures which appear to be reasonable in view of the particular operations and characteristics of the system in each case.*" (Emphasis added.)
>
> *(R. V. 1, p. 812.)*

This highlights both the infirmity and the danger inherent in the undisclosed and uncontrolled allocation procedures and processes of the Commission, which we are told by the Commission is the so-called "demand and commodity" method and which the Commission generally describes *(R. V. 1, pp. 59-60; Comm. Br., pp. 42-45)*. That is all that is forthcoming except the final result, and that is not broken down even as between expenses and return *(R. V. 1, p. 61)*.

This entire technical question of allocation, from a legal point of view, is in confusion and clouded with suspicion. As yet it has not received from the courts the judicial consideration and study which it must have, if it is to be removed from the range of the uncontrolled and non-reviewable discretion of the Commission, which is the present state of affairs.

End Result and Due Process.

The Commission order, which includes the opinion *(R. V. 1, p. 66)*, "in its entirety" is inter-related throughout. The amount of "rate reduction available" *(R. V. 1, p. 61)* is intimately connected with and results directly from the "excess earnings" and the "allocation" thereof *(R. V. 1, pp. 58, 61)*. The "excess earnings" in turn stem from "income available for return" *(R. V. 1, p. 58)*. This, in its turn, is produced by subtracting "expenses" from "gross revenue," after which the return allowed is applied to the "rate base." Obviously, if any of the many essential and supporting Commission conclusions or findings are not "supported by substantial evidence," is inconsistent with the evidence, or is without authority of or contrary to law, the Commission's order crumbles. This follows logically as a matter of ordinary sense and common understanding. Such is the inevitable relation of cause and effect. And such is the law—as declared by this Court *(Natural Gas Pipeline Company* case, 315 U.S. 575, 586, 62 S. Ct. 736, 743).

Before the "end result" doctrine can come into play four prerequisites must be met according to the declaration of this Court in the *Natural Gas Pipeline Company* opinion, *supra,* to-wit: (1) "a fair hearing," and all that is involved therein under law, (2) "proper findings made," (3) "statutory requirements satisfied," both by Commission and Court, and (4) "limits of due process" must not be "overstepped." These four prerequisites are not mere words; they relate to the *substance of rights and duties* under our constitutional system.

It is to be recognized that the order *"in its entirety"* in this case comprehends some 17 enumerated findings and conclusions, as well as the entire opinion incorporated therein by express reference *(R. V. 1, pp. 66-69)*. Moreover, "the facts before it" (the Commission) are *all* the evidentiary matters in the record. These then are the measures and guides which this Court, in conformity with constitutional requirements and its uniform decisions has declared must be "viewed" on review. The reviewing function of the courts is judicial and "does not trench upon, or involve the

exercise of, administrative authority" nor can it "be regarded as an attempt to vest in the court an authority to revise the action of the Commission." It is government by law.

It is evident from the record in this case and the law applicable thereto, which have been examined and presented generally, *supra,* that the Commission has proceeded in reliance upon the erroneous construction and application of the law as related to numerous issues; that it has failed to make essential findings; that many of such findings as it did make respecting material and substantial issues are not supported by "substantial evidence"; and that "the end result of its rate order" is "arbitrary."

The Commission produced a forced result, not alone by refusal to receive evidence which was relevant, competent, material and vital to petitioner in this proceeding, but also by misapplication of the evidence under assumptions contrary to fact. The order cannot be made effective without depriving the petitioner of its rights and properties contrary to the requirements of due process of law.

The Court of Appeals indulged assumptions freely but made no real inquiry into the state of the law applicable to the various issues in this case.

The Court of Appeals by the cumulative presumptions and burdens of proof which it has imposed upon this petitioner and by the numerous obstacles which it has erected to obstruct its own judicial path, has rendered completely nugatory the judicial review to which this petitioner is of right entitled under *Section 19(b)* of the Gas Act. That Court indulged recital after recital throughout its opinion to explain why it was unable to decide or even to examine into the question of abuse of the administrative "discretion" and "prerogatives."

"Of what avail" are the powers, the duties, the requirements and the limitations of the Natural Gas Act and other controlling law of the land as declared and enforced throughout the years by the orders and mandates of this Court, if they can be ignored, disregarded and "overpassed with impunity by the very agencies of government"—in this case,

the Commission and the Court of Appeals—which were created and directed to execute, preserve and enforce them!

Wherefore, respectfully, this petitioner asks this Court fully to review this case to the end that grievous and irreparable injury be not inflicted upon this petitioner and that the present uncertainty and confusion in the law be clarified and settled.

Respectfully submitted,

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APPENDIX A.

Pertinent Sections of the Natural Gas Act. (15 U. S. C. 717.)

NECESSITY FOR REGULATION OF NATURAL-GAS COMPANIES.

Section 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

RATES AND CHARGES, SCHEDULES, SUSPENSION OF NEW RATES.

Section 4. (a) All rates and charges made, demanded or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * * * *

(e) * * * At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over

other questions pending before it and decide the same as speedily as possible

FIXING RATES AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION.

Section 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. * * *

ASCERTAINMENT OF COST OF PROPERTY.

Section 6. (a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

REHEARINGS, COURT REVIEW OF ORDERS.

Section 19. (b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the Circuit Court of Appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the

Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

INDEX.

Authorities Cited.

SUPREME COURT OF THE UNITED STATES

October Term, 1946.

No. 556

CITIES SERVICE GAS COMPANY, a corporation,
PETITIONER,

vs.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; the CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; and CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, RESPONDENTS.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

REPLY BRIEF ON BEHALF OF PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The brief of respondent Federal Power Commission, resisting the issuance of writ of certiorari herein, is an artful and somewhat adroit evasion and inversion of the issues of fact and of law presented in this record.

Rarely is a litigant subjected to such high-handed disregard of both the facts and the law and to such arbitrary excess and abuse of procedures and the ordinary processes of reasoning, as are disclosed by this record, including the brief now under discussion.

The "Questions Presented," as formulated by counsel for respondent Commission *(Comm. Br., pp. 2-3)*, are cleverly

misleading and confusing, as we point out with particularity later herein. Moreover, a mere re-recital of the Commission views and conclusions *(Comm. Br., pp. 3-10)*, it appears, is expected to foreclose all issues. The almost off-hand manner in which all questions of law are brushed aside and dismissed by a sentence or a phrase actually serves to disclose the doubt and misgivings of those who prepared the document in question. The brief is neither forthright nor accurate in the summary treatment indulged as to the facts directly in issue and the law controlling.

The Right of Review.

The failure and refusal of the Court of Appeals to perform any real function of actual review whatever, as directed by *Section 19(b)* of the Gas Act[1] and required by this Court,[2] is disposed of by footnote reference as a mere incidental matter *(Comm. Br., p. 3)*. The statutory standard of "fair and reasonable," the question of "pragmatic adjustments which may be called for by particular circumstances" and the insufficiency of the evidence and the findings to support the Commission order are ignored in the Commission brief as well as by the Court of Appeals. The idea seems to be that the Commission assertion that its conclusion is "fair and reasonable" and "liberal" *(Comm. Br., p. 6)* concludes the entire matter. This philosophy of benevolence and liberality is an ever present attribute and expression of personal government. Under this theory of control, the petitioner is to be subjected to the impossible burden that it must be "conclusively shown" by it that the Commission action "will prevent the company from operating successfully as a public utility,"[3]—that is, not alone as to its regu-

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1. "Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. * * * The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." See Pet. for Certiorari, p. 4, footnote 3.

2. Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749; Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 626, 65 S. Ct. 850.

3. Opinion Court of Appeals herein, R. V. 3, p. 1332; 155 F. 2d, 694, 701.

lated business and properties but including also its unregulated business and properties as well *(Comm. Br., p. 6)*.[4] It is not sufficient, according to the Court of Appeals, that the record disclose that the order is "unjust or unreasonable,"[5] and that it visits grievous injury or irreparable injury upon the utility. There must be actual destruction, which prevents the "utility" from functioning as such before the statutory court of review has "the right to intercede." Moreover, however deficient the record may be to support the Commission action, the burden imposed is not merely to overcome "a presumption of validity," *(Federal Power Comm. v. Hope Natural Gas Co., supra)*, but also to prove "conclusively" the resulting destruction, notwithstanding *Section 19(b)* of the Gas Act, which requires adequate findings supported by "substantial evidence." The application of any such perversion of the statute and common right, as the record herein manifests was here indulged, is administrative finality and supremacy as well over all principles, processes and agencies of government. Yet to this untenable and amazing position of the Court of Appeals in this case *(R. V. 3, p. 1332)*, the Commission now openly subscribes *(Comm. Br., pp. 12-13)*.

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4. "Accordingly, the Commission found 'the reasonable *rate base* for the company *as an assembled whole* and an established natural gas utility' to be not more than $48,567,756 (R. I. 67-68, 50). *On that rate base, it allowed* an annual return of 6½% (or $3,156,904), which it found to be 'fair and reasonable' and 'liberal' (R. I. 68, 52)" (*Comm. Br., p. 6*). The substance of the foregoing language is to be noted. Clearly the Commission under Section 1(b) has no regulatory jurisdiction over sales other than "sales for resale," yet here it is said the Commission "allowed an annual return" on the unregulated as well as the regulated operations and business, for the "rate base" referred to embraces all properties and operations of the petitioner. This serves to illustrate the indifference and disregard by the Commission of the limits of its statutory authority.

5. Federal Power Comm. v. Hope Natural Gas Co., 320 U. S. 591, 602, 64 S. Ct. 281, 288.

ARGUMENT.

I.

Under the title heading "Production and gathering facilities" *(Comm. Br., pp. 10-13)*, counsel purport to deal with the several issues of jurisdiction over production and gathering, the rate base of natural gas reserves, and allocation, all mingled in their statement of "Questions Presented." *(Number 1, Comm. Br., p. 2.)*

It is asserted *(Comm. Br., pp. 10-11)*, quoting from the opinion of the Court of Appeals herein, that "the question of including production and gathering facilities in the rate base" has been "squarely met and conclusively decided" by this Court.[6] It is then sought by counsel to identify the issue of "fair value" of "those facilities" as a mere "alternate contention" to the question of jurisdiction over "production or gathering" *(Comm. Br., p.)*. It is said the so-called "alternate contention (had been) rejected in those cases."[7]

Commission counsel make two contentions:

(1) The first *(Comm. Br., p. 11)* is that Mr. Justice Jackson, despite his specific declaration of position as to the meaning of *Section 1(b)* of the Gas Act in the *Colorado Interstate Gas Company* and *Canadian River Gas Company* combined case, *supra,* and as to the meaning of *Section 201(b)* of the Power Act (which parallels *Section 1(b)* of the Gas Act) in the *Connecticut L. & P. Company* case, *supra,* nevertheless, by his concurrence in the *Panhandle Eastern Pipe Line Company* case, *supra,* "is in full accord with the prevailing view," so-called, declared by Mr. Justice Douglas and his three concurring associates in the *Canadian River Gas Company* case.

In the *Panhandle* case, on the limited review there granted that Company, the sole issue before this Court was

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6. Citing generally, Colorado Interstate Gas Co. v. Federal Power Comm., 324 U. S. 581; Panhandle Eastern Pipe Line Co. v. Federal Power Comm., 324 U. S. 635, 648; Federal Power Comm. v. Hope Natural Gas Co., 320 U. S. 591, 606.

7. See Petition for Writ of Certiorari herein, pp. 6, 7-9, 29-30, 30-32, 47-49, 49-58.

the question of allocation. Furthermore, while Mr. Justice Douglas therein did state that the question of "inclusion of its production and gathering facilities in the rate base" was "controlled" by the *Canadian* case, he thereafter expressly excluded that question from the *Panhandle* case on the ground that *Panhandle,* not having objected to such inclusion in its petition for rehearing before the Commission, "is accordingly precluded by *Section 19(b)* of the Act from attacking the order of the Commission on the ground that they are included."[8] Counsel with equal force could have argued that the late Chief Justice Stone, despite his vigorous dissent in the *Canadian* case, nevertheless, in the *Panhandle* case was "in full accord with the prevailing view," so-called, for the official report of that case also states "Mr. Chief Justice Stone concurring."[9]

While adding a footnote *(Comm. Br., p. 11)* to explain "the concurring opinion" of Justices Roberts, Reed and Frankfurter, counsel overlooked the fact that the concurrence of the late Chief Justice Stone, and of Mr. Justice Jackson as well, must be taken to relate only to the actual and sole issue of allocation before this Court in that case.

(2) In their discussion *(Comm. Br., pp. 11-13)* supporting the exclusion by the Commission of all evidence of "fair value" of natural gas properties and reserves as "immaterial and irrelevant" *(R. V. 3, p. 1331),* counsel imply, but do not directly state, that the exclusion of such evidence in this case was not predicated upon the construction given to *Section 6(a)* of the Gas Act, as well as to *Section 208(a)* of the Power Act, by the Commission in *Detroit v. Panhandle Eastern Pipe Line Co.,* 45 P.U.R. (n.s.) 203, and in *Chicago District Electric Generating Company,* 39 P.U.R. (n.s.) 263. Based upon such implication, counsel conclude that the Commission did not misconceive "the applicable legal criteria" *(Comm. Br., p. 12).* The argument must be rested on implication because the facts of this record and the history of this case are to the contrary.

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8. Panhandle Eastern Pipe Line Co. v. Federal Power Comm., *supra,* 324 U. S. at pages 648-649, 65 S. Ct. at page 828.

9. Panhandle Eastern Pipe Line Co. v. Federal Power Comm., *supra,* 324 U. S. at pages 650-651, 65 S. Ct. at page 829.

In this case the Commission, through its Examiner *(R. V. 1, pp. 160-166)*, and thereafter in its Opinion *(R. V. 1, pp. 31-32)*, excluded all evidence of "fair value" of all and every part of the properties, including the gas reserves of petitioner, on the theory developed by the Commission in *Detroit v. Panhandle Eastern Pipe Line Company, supra,* and *Re Chicago District Electric Generating Company, supra.* As stated, both by the Examiner and by counsel for the Commission, "the actual legitimate cost of these leases can be determined from the books," and therefore there is not presented a case in which "the exigencies of the particular situation require such a determination" of fair value *(R. V. 1, pp. 161, 163, 164, 165-166).*[10]

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10. Following are excerpts from the objection of counsel for the Commission to the reception of any and all evidence of "fair value" of natural gas reserves and other properties of petitioner and the ruling of the Examiner sustaining the objection:

> Counsel for Commission: "I have just quoted an excerpt from Section 6(a) of the Natural Gas Act.
>
> "Now, the Commission has held that, under that section, in the absence of any showing by the company, that consideration of fair value must be given, or in the absence of any evidence that the original cost of the properties of the company can not be determined, that re-production cost evidence or evidence of so-called 'fair value' must be excluded.
>
> * * * * *
>
> "In other words, under the evidence thus far adduced it is clear that the original cost of these leases has been already ascertained by the commission's staff from the books and records, and so far as it appears in the evidence to date, it can be ascertained from the books and records of the company.
>
> * * * * *
>
> "I believe your Honor is bound by the decisions of this Commission, and I believe the Commission has spoken with respect to this matter and has received the sanction of the United States Supreme Court *in adopting the original cost formula and rejecting all others. I therefore urge upon your Honor to exclude from this case any evidence of so-called value of the gas leaseholds.*"
>
> * * * * *
>
> Trial Examiner: "Well there isn't any difference of opinion as to what the Federal Power Commission has held on the subject, is there?"
>
> Counsel for Company: "I don't think there is, no. I think they have held that value has nothing to do with it."
>
> Trial Examiner: "You are familiar with the Commission's

Additionally, the Commission witnesses, *Kenneth W. Smith,* Assistant Chief Accountant, *(R. V. 1, pp. 152-153)* and *Charles W. Smith,* Chief of the Commission Bureau of Accounts, under whose direction the various Commission exhibits were prepared *(R. V. 1, pp. 183-184, 385-387),* declaring the viewpoint of the Commission, testified, apparently as legal experts, to the effect that it is not proper in a valuation case "under the Act" to do other than arrive at actual legitimate cost as the rate base of all properties, including natural gas reserves.

The law, according to both the Commission and its staff, requires the "cost" formula, and no other. There is no choice. No discretion is allowed to adopt any other standard for the determination of rate base, even to conform to the statutory standard of "fair and reasonable."[11] The view

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opinion in the Chicago District Electric Generating Corporation case, are you?"

Counsel for Company: "Yes, sir."

Trial Examiner: "In which the Commission said, speaking of Section 208-A of the Federal Power Act, which is identical with Section 6-A of the Natural Gas Act, that 'this section contemplates the ascertainment of facts, other than the actual legitimate cost, which bear on the fair value of the company's property in rate-making procedures, when the exigencies of the particular situation require such a determination.'

"Is it your contention that the exigencies of the particular situation here require such a determination?"

Counsel for Company: "I would think that, if this witness would testify, for instance, that these leases are worth 20 million dollars, and the Commission's staff recommended to us $400,000 for a rate base, that that showed the cost was no element to be considered alone in determining a rate base, and that value must be given consideration where such an exigency exists."

Counsel for Commission: "I submit that that completely begs the whole question."

Trial Examiner: "It seems to me it would defeat the whole purpose or the Commission's construction, at any rate, of the language of the statute.

"There is no contention here, is there, that the actual legitimate cost of these leases can not be determined from the books?"

Counsel for Company: "No. There is no such contention, Mr. Examiner."

Trial Examiner: "Objection is sustained. You may make your offer of proof."

11. Panhandle Eastern Pipe Line Co. v. Federal Power Comm., *supra,* 324 U. S. at page 649, 65 S. Ct. at page 828.
Federal Power Comm. v. Hope Natural Gas Co., *supra,* 320 U. S. at page 602, 64 S. Ct. at page 287.
Colorado Interstate Gas Co. v. Federal Power Comm., *supra,* 324 U. S. at page 605, 65 S. Ct. at page 840.

urged is that "rate base" is fixed and limited inevitably by "cost," as a matter of law.[12] The Commission evidence, the Commission exhibits, the Commission opinion *(R. V. 1, pp. 31-32)* and the Commission order *(R. V. 1, p. 66)* so manifest and so declare.

The implication of counsel *(Comm. Br., p. 12)*, that the so-called Commission finding that "no necessity was shown to exist for the consideration * * * of 'fair value' of its property" *(R. V. 1, p. 66)* indicated that in this case some sort of a selection between rate base formulas had been made, and hence the Commission did not misconceive "the applicable legal criteria," is extremely disingenuous.

The issue of "fair value" herein presented, was neither met nor decided by this Court in the *Colorado Interstate Gas Company*, the *Canadian River Gas Company*, or the *Panhandle Eastern Pipe Line Company* cases, *supra*. That issue, as the opinion of Mr. Justice Douglas in the *Canadian River Gas Company* case, *supra*, specifically states, was not presented in the limited review granted in those cases.[13]

In the case of *Federal Power Commission v. Hope Natural Gas Company, supra*, the Company there involved offered no evidence of the fair value of its gas reserves. This was pointed out by Mr. Justice Jackson in the *Canadian Rievr Gas Company* case, *supra*, (324 U.S. at 645, 64 S. Ct. at 308), and it similarly was pointed out by Judge Phillips in his dissenting opinion in this case *(R. V. 3, p. 1347)*.

The Commission brief, after embracing the false thesis of the Court of Appeals that the reviewing courts "have not the right to intercede unless it is conclusively shown that

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12. But see to the contrary: Canadian River Gas Co. v. Federal Power Comm., 324 U. S. 581, 603-604, 65 S. Ct. 829, 840, and cases cited; Federal Power Comm. v. Natural Gas Pipeline Co., *supra*, 315 U. S. at page 586, 62 S. Ct. at page 743.

13. See Canadian River Gas Co. v. Federal Power Comm., *supra*, 324 U. S. at page 605, 65 S. Ct. at page 841, where Mr. Justice Douglas, speaking for himself and Justices Black, Murphy and Rutledge, declared: "Hence we cannot say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost. That could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case."

failure to give consideration to the fair value of properties, including the valuable leasehold estates, will prevent the company from operating successfully as a public utility" *(Comm. Br., pp. 12-13)*,[14] indulges distortion, speculation and conclusions *(footnote 5, page 13 of the brief)* predicated on the theory of Commission benevolence and liberality. Among other things, in seeking to evade and gloss over the nonsensical and "delirious" consequences of the application of the Commission rigid "cost" formula to natural gas reserves *(Pet. for Certiorari, pp. 8, 24-26, 56-58)*, it is said "The comparison also omits from the figures for the cost of produced gas the expenses of exploration and development * * *." This is not true. The comparison was based on Commission exhibit 30 *(Pet. for Certiorari, pp. 24-26, 56-58)*. Reference to that Commission exhibit *(R. V. 3, p. 1200)* discloses that "exploration and development costs" were not omitted. The direct implication from the closing sentence of the footnote: "The Commission's allowance of $295,439 for such exploration and development costs *(R. I, 57, III, 999, 963)* is the equivalent, when capitalized at 6½%, of an additional $4,500,000 in the rate base," is that such allowance of *actual expense* was a matter of grace and generosity on the part of the Commission. As a matter of fact if such allowance were not a proper expense allowance under the Act, the Commission had no lawful authority to allow it, either as to produced or purchased gas. The same is true of other production "expenses." The footnote pointedly reflects the attitude and action of those who conceive themselves to be possessed of an uncontrolled but always a benevolent "discretion."

II.

Under the subject title "Existing depreciation and depletion," Counsel *(Comm. Br., pp. 13-15)* presumably would deal with Question Presented, number 2, which they state to be "whether the Commission's subsidiary finding, in regard to existing depreciation, that 'a qualified staff engineer inspected the company's properties * * *,' was supported by substantial evidence" *(Comm. Br., p. 2)*. In fact, the discus-

14. See Pet. for Certiorari and Supporting Brief, pp. 3-6, 7-9, 41-46, 47-58.

sion of counsel is not responsive to the question as posed by them, since the record discloses affirmatively and conclusively from the evidence of the Commission itself that the "finding" in question is not supported by but contrary to the evidence *(Pet. for Certiorari, pp. 9-11, 58-62)*. Counsel do not even assert that it is supported by the record *(Comm. Br., p. 14)*. However, in order to discount and by-pass it, the discredited finding is characterized by counsel as "a subsidiary finding." Thereupon counsel, as did the Court of Appeals *(R. V. 3, pp. 1333-1335)*, argue that for various reasons, none of which is reflected in the Commission so-called findings,[15] "inspection" of the pipeline system, which constituted 70% of the Commission total rate base *(Comm.*

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15. It is claimed by counsel among other things (*Comm. Br., p. 15*) that "the witness inspected reclaimed pipe," the idea being this was a valid substitute for inspection of any part of the 4300 miles of the pipeline system, which the Commission found he inspected, but which admittedly he did not inspect even to the extent of one length of pipe. He testified that he examined "reclaimed pipe in the Company's 'storage yards.'" In these yards "the pipe as it is reclaimed from the pipeline system is graded and sorted in the pipe storage yards, and racked, and as the occasion arises for its re-use it is reconditioned." The purpose of making inspections of pipe in these yards, the witness testified, is "to determine the action of the erosive elements that are in the soil on the pipe, to make a study of corrosion and the amount of deterioration of pipe which has been in the soil for a period of years. * * * It gives us some idea" of the Company's retirement policy (*R. V. 1, pp. 438-439*). The witness of course could not know, and did not testify that he did know, anything whatever about the previous history of the particular sections of pipe which he examined, all as graded, sorted and racked in the storage yards. The witness had no records of pipe in stock in storage yards (*R. V. 1, p. 489*). He simply examined various sections of pipe without any information whatever as to where, how long and under what soil and other conditions the pipe had been used. Nor did he know whether the pipe had been retired from service because of deterioration or for other reasons.

The "2020 pipe inspection reports" referred to had nothing whatever to do with "a service life study." They simply embodied observed facts of the then condition of pipelines by the examining company engineers. The reports did not embody or disclose the conclusions of such engineers as to the then condition of the pipelines (*R. V. 1, p. 527*).

The Company's rates of depreciation, not based upon "cost" of plant, had been altered frequently during the years prior to 1941 (*R. V. 1, pp. 518, 557-558*). The fact that "presently," that is, in 1941, (*Comm. Br., p. 15*) the rates embodied in Commission Exhibit 12 for the most part were those then in use by the Company but were applied to a totally different valuation base of its properties, leaves counsel's contention without logical bearing or consequence.

Counsel for the Commission are far too able and penetrating in their understanding not to know that the superficial explanation offered by them is without substance, and therefore advanced to evade the real issue, the insufficiency of the record to support the Commission discredited finding, which in no sense is "subsidiary." It is foundational but not true.

Ex. 5, pp. 977-978; R. V. 1, p. 50), was not necessary. (See *Pet. for Certiorari, pp. 58-61)*. The Commission "finding" under consideration (quoted at *pages 9-10, Pet. for Certiorari)* is predicated on the testimony of the *sole* Commission witness on depreciation *(R. V. 1, pp. 427-430)*. That witness undertook to lay the foundation for Commission Exhibit 15 entitled "Services Lives and Annual Depreciation Rates." This exhibit *(R. V. 3, pp. 1127-1141)* it is said embodies a factual determination of the elements of depreciation, both physical and functional *(R. V. 1, p. 427)*. The exhibit was adopted and relied upon in Commission Exhibit 12, entitled "Annual and Accrued Depreciation" *(R. V. 3, pp. 1039-1088)*. See Schedule 1 *(R. V. 3, p. 1039)* and Schedule 2 *(R. V. 3, p. 1042)* thereof. The Commission thereafter in its opinion and order proceeded in reliance upon these two correlated exhibits *(R. V. 1, pp. 44, 45, 47, 67, 68)*.[16]

The unsupported Commission "finding" *(R. V. 1, p. 44)* is the only portion of the Commission's argumentative treatment of the matter *(R. V. 1, pp. 43-48)* which even purports to deal with "*existing depreciation*" as a fact. That "finding" of course was required to support and give authority to Commission Exhibit 15.[17] That exhibit in turn was essential as a foundation to any actual or purported determination of "existing depreciation" by the Commission *(R. V. 1, pp. 43, 47)*. This is perfectly obvious from the rec-

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16. In the Commission opinion it is said: "The depreciation rates recommended by the staff in computing both the annual depreciation expense and the reserve requirement (accrued depreciation) were derived from the average service lives of the various classes of property owned by the Company."

(*R. V. 1, p. 45*)

17. The Commission depreciation engineer (*R. V. 1, p. 72*) on direct examination testified specifically as to the purpose of field inspection and examination:

> "The purposes of the field examination were to observe, when possible, the extent to which physical deterioration had occurred; observe the measure of protection afforded to depreciable property by maintenance; determine the actual existence of the items of property as shown in the inventory and property records of the company; observe any conditions which would affect judgment based on previous experience in the determination of service life; become familiar with the operating records at their origin; become acquainted with local conditions; determine the used and useful nature of the units of property and the proper classification of such property."
>
> (*R. V. 1, p. 430; R. V. 3, pp. 1127-1128*)

ord evidence and exhibits above referred to the attention of the Court.

III.

Under the heading "Profits from Extraction Operations" *(Comm. Br., pp. 15-18)*, Counsel do not meet the issue involved in this record and presented by the Petition for Certiorari *(pp. 11-13, 33, 62-66)*. The question is: Whether the Commission lawfully may exercise rate-regulatory authority over the separate and independent natural gasoline extraction plants of Cities Service *Oil* Company, and the operations thereof, precisely the same "as if they (such plants and operations) belonged to this petitioner," which they do not?

Number 3 of the "Questions Presented," as adroitly framed by Commission counsel *(Comm. Br., p. 2)*, indicates that the issue is simply whether the Commission in this rate case may inquire into the reasonableness of contracts between this petitioner and an affiliate, Cities Service *Oil* Company. This concededly the Commission may do. Counsel's entire discussion distorts and evades the uncontroverted facts of this record *(Pet. for Certiorari, pp. 11-12, 62-66)*. They are careful not to state the fact that the Commission exercised direct rate-regulatory control over, and conducted a rate case as to, the *Oil* Company's plants and operations in question "and a 6½% return was allowed on the investment rate base of the Oil Company" *(Comm. Opinion, R. V. 1, p. 53)*. No finding or other reference of any kind to this procedure is to be found in the Commission Findings and Order *(R. V. 1, pp. 66-70)*.

This procedure counsel assert *(Comm. Br., p. 17)* "is no more regulation of the gasoline extraction business than the Commission's use of data relating to production and gathering constitutes regulation of those activities," citing the *Natural Gas Pipeline Company*, the *Hope Natural Gas Company*, the *Colorado Interstate Gas Company*, the *Canadian River Gas Company*, the *Panhandle Eastern Pipe Line Company* cases, *supra*.

It should not be necessary now to answer such a contention. That contention was rejected in the *Canadian River*

Gas Company case, *supra*. There eight Justices of this Court declared themselves to the effect that the inclusion of the production and gathering properties of Canadian Company in the Commission "cost" rate base was *in fact* the exercise of rate-regulatory jurisdiction over such properties and facilities. Four of the Justices, speaking through Mr. Justice Douglas, so construed the Natural Gas Act as to enable them to conclude that the Commission had lawful authority and jurisdiction so to do.[18] Four of the Justices, speaking through the late Chief Justice Stone, were emphatic in their conviction that, while the inclusion of such properties and facilities in the utility rate base was *in fact* rate-regulatory control, there was no authority in the law for the exercise of such a control.[19] Mr. Justice Jackson took the position that the inclusion of the production or gathering facilities in the rate base did not constitute "direct regulation upon that activity" which would have "exceeded its jurisdiction," but amounted merely to inquiry and examination of conditions and events quite beyond the regulatory control of the Commission where they are thought to affect the cost of that which the Commission is directed to determine.[20] The view of Mr. Justice Jackson was not accepted by the remaining members of this Court. Moreover, as yet there has been no "authoritative determination" by a majority of this Court on "the principles of law involved" in connection with the determination of the question of jurisdiction of the Commission over "The production or gathering of natural gas."[21]

In the case of *United Fuel Gas Co. v. Commission*, 278 U.S. 300, 321, 49 Sup. Ct. 150, 156, cited by counsel *(Comm. Br., p. 17)*, the net return derived from the process of extracting natural gasoline from natural gas was apportioned by the State Commission and the Supreme Court of West

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18. Canadian River Gas Company v. Federal Power Comm., *supra*, 324 U. S. at pages 597-604, 65 S. Ct. at pages 837-840.

19. Canadian River Gas Company v. Federal Power Comm., *supra*, 324 U. S. at pages 615-625, 65 S. Ct. at pages 845-850.

20. Canadian River Gas Company v. Federal Power Comm., *supra*, 324 U. S. at pages 608-615, 65 S. Ct. at page 842.

21. Pet. for Certiorari, pp. 6, 47-49.

Virginia at the ratio of 50% to each of the two affiliates, one of which had been organized for the express purpose of taking over most of such profits. This division the Supreme Court of the United States approved, declaring it was conformable to evidence in the record, showing that the Commission order actually reflected "dealing at arm's length." The implication of counsel that the Commission here so proceeded is not true. Here the Commission treated the *Oil* Company and the *Gas* Company as one company *(R. V. 2, p. 792)* and made no effort whatever to adjust the contract arrangement on the basis of "arm's length dealing" *(R. V. 2, pp. 798, 802)*. All net return from the extraction operation averaged for the years 1939-1941 was divided, $380,000 to the *Gas* Company and $43,784 to the *Oil* Company, a ratio in excess of 8 to 1. Under this Commission fixation the $43,784 allowed to the *Oil* Company *ostensibly* represented 6½% return upon the Commission rate base imposed on the extraction properties of the *Oil* Company *(R. V. 1, p. 54)*. This was on the theory that all earnings in excess of 6½%, even from unregulated business, are non-permissible "excess earnings" *(R. V. 2, p. 800)*, a legal assumption *constantly* indulged by Commission, its staff and counsel.

The contention made by counsel *(Comm. Br., p. 17)* as well as by the Court of Appeals, to support the Commission exercise of direct rate-regulatory control over the gasoline extraction plants and operations of the *Oil* Company, that otherwise a regulated gas utility would be enabled "to syphon off profits to nonregulated affiliates," does not stand up. Heretofore, in many cases and as a matter of established procedure, commissions and courts alike, *without attempting to exercise regulatory control over the nonregulated affiliate*, have made inquiry into and required that the contractual relations between affiliates be reasonable and equivalent to "arm's length dealings."[22]

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22. Smith v. Illinois Bell Tel. Co., 282 U. S. 133, 51 S. Ct. 65.
United Fuel Gas Co. v. Railroad Comm., *supra*.
See, dissenting opinion, Chief Justice Stone, in Canadian River Gas Company case, *supra*.

IV.

The discussion by counsel *(Comm. Br., pp. 18-20)* of the disallowance of *all* Federal income tax as an item of expense, as an element of cost of service, and from the cost of service allocation, is not in conformity either with the facts of this record, the law generally or in conformity with any announcement in the *Canadian River Gas Company* and *Colorado Interstate Gas Company* cases, *supra.* The Commission theory of disallowance was not applied in either the *Canadian River Gas Company* or *Colorado Interstate Gas Company* cases, *supra.*[23] That theory is that, for Federal income tax purposes, the Commission may limit the petitioner's earnings upon both the regulated and the unregulated business to 6½% on a "rate base" embracing *all* property, unregulable as well as regulable *(R. V. 1, p. 57; Comm. Br., pp. 6, 18; R. V. 3, p. 1337).* If upon such a tax base no Federal income tax theoretically would result according to Commission computation, then no allowance for such taxes *actually* accruing need be made by the Commission.[24] The Commission has no authority to set up any such tax base. Nor does the Commission have any lawful authority for the purposes of tax computation or otherwise to place a 6½% or any other limitation upon the earnings of the unregulated business.[25] Federal income tax is determined by the taxing authorities, and under the revenue laws, with reference to the business as a whole, as pointed out by Judge Phillips in the Court of Appeals *(R. V. 1, p. 1349).* Such a computation of Federal income tax was made by the Commission staff *(Comm. Ex. 41, R. V. 3, pp. 1264-1265).* In that computation all expenses and deductions, applicable alike to the regulated and unregulated business, are reflected and included. Such has been the pro-

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23. See opinion Mr. Justice Douglas, 324 U. S. at page 587; 65 S. Ct. at page 832.

24. That such is precisely the Commission position is also clear from the assertion of counsel (Comm. Br., p. 18) that "* * * if petitioner made no more profit on its *non-regulable* than on its regulable business there would be no such tax liability to be allocated."

25. See Panhandle Eastern Pipe Line Company case, *supra*, 324 U. S. at pages 641-642, 65 S. Ct. at page 825; Colorado Interstate Gas Company case, *supra*, 324 U. S. at pages 586-589, 65 S. Ct. at pages 832-833.

cedure *which the Commission heretofore purported to follow* in its so-called "cost of service allocation," which is developed from cost of service, which, in turn, has its foundations in all expenses and deductions chargeable against gross income, including Federal income taxes. The results, whatever figures are paraded by Commission counsel in their now offered exhibit *(Comm. Br., p. 20. footnote 10)* reflect *all* expenses and deductions attributable to both the regulated and the unregulated business, except in this particular instance Federal income taxes. It is perfectly obvious that had that portion of the expenses and deductions attributable to the unregulated business been excluded, the Federal income tax conclusions of Commission staff and counsel *(Comm. Br., pp. 19-20)*, would have been vastly different. Counsel in fact take advantage of *all* expenses and all other deductions *in full*, to arrive, through mathematical mechanics, at a result which they assert "clearly wipes out that taxable income" on the regulable business *(Comm. Br., p. 20)*. The *undefined* "statutory tax deductions" which we are told *(Footnote 13, Comm. Br., p. 20)* "would relieve petitioner of income tax liability even though for rate purpose it earned 6½% return," of course relate to petitioner's business *in its entirety*, regulated and unregulated. Here again we gain an insight into the Commission's theories and related practices of disallowance of expense and allocation of cost.

Counsel's computation *(Comm. Br., pp. 19-20)* proves far too much. They find themselves obliged to offset taxable income, which they state is allocable to regulated business, with the rate reduction order itself. Their statement in that behalf is, "The net income of the regulable business ($7,614,407) is *roughly* 79% of the total net income ($9,550,793) of the entire business. 79% of petitioner's taxable income for 1941 ($6,057,181) is *$4,829,390*; this represents the taxable income allocable to regulated business, and the corresponding rate reduction *($5,499,655)* clearly wipes out that taxable income" *(Comm. Br., pp. 19-20)*. Thus, under the Commission order of rate reduction by the accounting and mathematical devices indulged by counsel, the so-called taxable income allocable to regulated business is wiped out entirely and appears as a red figure, $670,275.

Petitioner does not concede as suggested by counsel *(Comm. Br., p. 19)* "that if it earned no more than 6½% on the *over-all rate base,* there would be no federal income tax liability." Clearly there is no method by which such a computation and ascertainment could be made, without segregating revenue, expenses and other deductions as between a return of "6½% *on the over-all rate base*" and return on the unregulated business in excess of 6½%. There is nothing of the kind in the record.

It is also asserted by counsel *(Comm. Br., p. 19)* that if a federal income tax liability "should have been included in cost of service," petitioner would not recognize that "any such tax liability would be allocable to the non-regulable business." The meaning of this language is vague and ambiguous. However, petitioner's position is that Federal income taxes should be allocated as between the regulable and non-regulable business, so that each class of the business shall bear its fair share of the costs, of which Federal income taxes is one.[25]

The statement is made also that petitioner's computation of Federal income tax *(Pet. for Certiorari, pp. 13-14)* is erroneous because "the amounts of $380,000 and $65,000 are added to the petitioner's net taxable income" *(Comm. Br., p. 19, footnote 9).* The only Federal income tax computation in the record is Commission Exhibit 41 *(R. V. 3, pp. 1264-1265).* This exhibit, which petitioner followed in its computation, Commission counsel now find it necessary to repudiate.

V.

Commission counsel are quite in error in their assertions and unsupported conclusions as to "Cost of service allocation" *(Comm. Br., pp. 3, 20-21).* This petitioner does not agree with the so-called general "demand and commodity method" of allocation as differently applied by the Commission in each case to suit its own purposes. Nor does petitioner agree there is anything in this record from which the actual processes of so-called "Allocation of cost of service" are so disclosed that they can be tested by this Court or any other court, either as to "the governing considera-

tions of fairness" or as to "the judgment factors" which presumably guided the Commission. For example, the footnote under the topic "Federal income taxes" *(Comm. Br., pp. 19-20, footnote 10)* manifests the insufficiency of the Commission findings on the matter and manner of allocation, in which, of course, the prior disallowance of "expenses" and disposition of revenue," such as Federal income taxes and revenue from natural gasoline extraction operations, is basic and foundational.

It is said *(Comm. Br., pp. 19-20)* that the net income of the regulable business is "*roughly* 79% of the total net income." There is no disclosure in the Commission opinion, nor in any Commission exhibit, to that effect. The allocation procedures of the Commission, being as they are, counsel were forced to develop their own exhibit *(Comm. Br., pp. 19-20, footnote 10)*.[26] Moreover, nothing is disclosed, "roughly" or otherwise, as to the proportion of petitioner's properties devoted to the regulated business and that devoted to the unregulated business. The lack of forthrightness and clarity is patent. The Commission discloses the *actual* operation and effect of its processes of allocation only when necessary to defend its course of action. The entire subject of Commission allocation cries aloud for judicial supervision, review and correction.

"Allocation of costs," so-called, is "not a matter of the slide rule" and is not governed by "mere mathematics" or accounting theories or processes. "It involves judgment on a myriad of facts" and "considerations of fairness * * * govern." "The appropriateness of the formula * * * in a given case raises questions of fact * * *."[27] This, of course, means that the *precise* formula must be clear and specific. It also means that the application thereof in the particular case

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26. The same type of device was indulged by Commission counsel in *Colorado-Wyoming Gas Co. v. Federal Power Comm., supra*, in the Commission brief before this Court, in an attempt to point out the allocation path which the Commission claimed it followed in that case. The exhibit of counsel in that case was designated Appendix B of the brief. The purpose of that exhibit, as the exhibit here (*Comm. Br., pp. 19-20 and footnote 10*), was to make *some* disclosure to this Court as to the Commission procedure, not apparent from the opinion and order of the Commission.

27. Canadian River Gas Co. v. Federal Power Comm., *supra*, 324 U. S. at pages 586-591, 65 S. Ct. at pages 832-834.

must be disclosed, that is, the *prior* disposition of "expenses" and "revenue," in the "cost of service" fixation. This disclosure is as important as, and in some cases more important than, the apportionment in the *final* "allocation of cost of service." The propriety of the Commission "allocation," both in principle and in application, is for examination and review in each case, to insure that it is not "unfair" and does not "transgress the jurisdictional lines which Congress wrote into the Act."[28] To decide these vital questions, as well as to determine whether the path which the Commission claimed to have followed can be discerned by any other than a seer, it is essential that the court of review enter into and discharge its function and statutory duty of judicial review. This the Court of Appeals refused to do *(R. V. 3, p. 1339)*. As to this, Commission counsel are silent.

CONCLUSION.

The record, the applicable statutory law, the decisions of this Court and the Commission brief herein, all show that the rights of this petitioner have been ignored and disregarded by Commission and Court of Appeals alike. Unless this petition for certiorari is granted and a full review allowed, arbitrary, capricious and lawless action of an administrative agency will be sanctioned.

Respectfully submitted,

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28. Panhandle Eastern Pipe Line Co. v. Federal Power Comm., *supra*, 324 U. S. at pages 641-642, 65 S. Ct. 825.

INDEX

CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 556

CITIES SERVICE GAS COMPANY, A CORPORATION, PETITIONER

v.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; THE CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; AND CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion and order of the Commission (R. I, 28–70) are reported in 50 P. U. R. (N. S.) 65. The opinion of the circuit court of appeals (R. III, 1323–1349) is reported in 155 F. 2d 694.

JURISDICTION

The judgment of the circuit court of appeals was entered on April 30, 1946 (R. III, 1349–1350). A

petition for rehearing was denied on July 5, 1946 (R. III, 1393). The petition for a writ of certiorari was filed on September 30, 1946. The jurisdiction of this Court is invoked under Section 19 (b) of the Natural Gas Act and Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, in fixing petitioner's interstate wholesale natural gas rates, it was proper for the Commission to determine cost of service for petitioner's entire business, including production and gathering, and to include production and gathering facilities in the rate base; if so, whether to include such facilities in the rate base at their actual legitimate cost.

2. Whether the Commission's subsidiary finding, in regard to existing depreciation, that "a qualified staff engineer inspected the company's properties * * *," was supported by substantial evidence.

3. Whether it was proper for the Commission to credit against petitioner's operating expenses the excess profits of an affiliate's gasoline extraction plant processing petitioner's gas.

4. Whether the Commission's refusal to make any allowance for federal income tax in petitioner's operating expenses, was proper where the rate of return used by the Commission, if applied to petitioner's entire business, would result in no federal income tax liability.

5. Whether the findings on allocations of cost made by the Commission between petitioner's interstate sales for resale, and its other, non-regulable sales, are sufficient to support the order of the Commission.[1]

STATUTE INVOLVED

The relevant portions of the Natural Gas Act are set forth in the Appendix, *infra*, pp. 23–33.

STATEMENT

The proceedings before the Commission arose out of a petition filed on May 1, 1939, by the Public Service Commission of Missouri against Cities Service Gas Company, the petitioner herein, alleging that the rates charged by petitioner for natural gas sold to various distributing companies for resale to domestic and commercial consumers in numerous communities in Missouri were unjust, unreasonable and unduly discriminatory, and requesting an investigation and the fixing of reasonable and lawful rates. By order of July 26, 1939, the Commission directed petitioner to show cause why its rates should not be reduced. Upon consideration of petitioner's response, the Commission, on October 20, 1939, and

[1] Petitioner also formulates questions as to "Jurisdiction of the Commission and Scope of Review" (Pet. 3–5) and due process (Pet. 19–21). These issues deal generally with the same matters which are separately raised in the questions above set forth, and their resolution must depend on the same considerations.

on its own motion, instituted an investigation of all of petitioner's interstate rates and charges. (R. I, 25–28.)

Hearings were begun on November 30, 1942, and held thereafter for forty-one days through February 2, 1943. Members of the Missouri Commission and the State Corporation Commission of Kansas sat jointly with the Commission's Trial Examiner, and the Corporation Commission of Oklahoma was represented by counsel. The City of Kansas City, Missouri, as well as the Missouri Commission, participated in the hearings as interveners. (R. I, 28–29.) After submission of briefs, the Commission on July 28, 1943, issued its opinion and the interim rate order here under review, finding that petitioner's interstate wholesale rates were excessive and requiring petitioner on and after September 1, 1943, to reduce such rates by an amount corresponding to a reduction of $4,445,871 for the year 1941, which the Commission used as a test year (R. I, 28–70).

A. *The petitioner.*—Petitioner is a wholly owned subsidiary of the Empire Gas and Fuel Company (R. I, 30, II, 787), which is in turn a subsidiary of the Cities Service Company (R. I, 30, III, 935). Organized on February 1, 1922, as the Empire Natural Gas Company, petitioner acquired the properties of a number of other producing and transporting companies, and upon reorganization on November 30, 1926, under its

present name, it acquired still other producing and transporting properties; all of these properties were owned or controlled, directly or indirectly, by the Cities Service Company (R. III, 934–936, 945–946).

As a result of these and other transactions with affiliated companies, petitioner owns properties which include 4,300 miles of main and field lines, and which are operated as an integrated natural gas pipeline system (R. I, 30–31). These pipelines extend from production areas in Texas, Oklahoma and Kansas to serve a wide area in northern Oklahoma, eastern Kansas, southern Nebraska and western Missouri (R. III, 1125), the company's principal markets embracing the metropolitan areas of Kansas City, St. Joseph, Joplin and Springfield, Missouri, and Kansas City, Lawrence, Topeka, Leavenworth, Wichita and Hutchinson, Kansas (R. I, 30–31). At these points, the gas is sold at the distribution gates under various contracts of "sale for resale," and to a considerable number of industrial and other direct sale customers (R. III, 1151).

B. *The rate order.*—The Commission, in determining the reasonableness of petitioner's interstate wholesale rates, used 1941 as the test year and found the actual legitimate cost of petitioner's property in service on December 31, 1941, including leaseholds and facilities for production and gathering, to be not more than $66,977,654 (R. I,

33–43, 66–67). In so doing, the Commission found that the trial examiner had properly excluded evidence as to so-called "reproduction cost" or "fair value" of petitioner's properties since "no necessity was shown to exist for the consideration" of such evidence (R. I, 31–32, 66).

From the $66,977,654 found to be the actual legitimate cost of petitioner's gas plant in service as of December 31, 1941, the Commission deducted $21,804,449 for "actual existing depreciation and depletion" (R. I, 67, 43–48), determined by the "straight-line service life method" (R. I, 43–45) and the "unit-of-production" method (R. I, 47, note 26) on the basis of a study presented by the Commission's staff (R. I, 44, III, 1039–1088).

The Commission also included in the rate base $1,576,357 for construction work in progress (R. I, 67, 48) and $1,818,194 as a "proper and reasonable allowance for working capital" (R. I, 67, 48–50). Accordingly, the Commission found "the reasonable rate base for the company as an assembled whole and an established natural gas utility" to be not more than $48,567,756 (R. I, 67–68, 50). On that rate base, it allowed an annual return of 6½% (or $3,156,904), which it found to be "fair and reasonable" and "liberal" (R. I, 68, 52).

Using 1941 as the test year, the Commission found that the company's operating revenues were $17,360,930 (R. I, 52, 68). In determining the amount

of petitioner's income available as a return on investment, it found that the operating revenue deductions (e. g. operating expenses, depreciation, depletion, amortization and taxes) and exploration and development costs shown on petitioner's books during that year totaled $10,625,749 (R. I, 52). The Commission found that petitioner's affiliate, Cities Service Oil Company, in extracting natural gasoline and other residuals from petitioner's gas, derived profits which were excessive to the extent of $380,000 per year and that, for purposes of this proceeding, petitioner's operating expenses should be reduced by that amount (R. I, 53–55). Applying the "service life" and the "unit-of-production" methods (*supra,* p. 6), to the allowed plant cost, the Commission found and allowed $1,709,060, and $70,871 for annual depreciation and depletion, respectively (R. I, 56–57, 68). For exploration and development costs, the Commission allowed $295,439 (R. I, 57, 68). Of the $3,035,466 of federal, state and local taxes shown on petitioner's books in the test year, the Commission disallowed $84,783, representing over-accruals, and deducted $1,882,148, representing "the reduction in the Company's 1941 Federal income tax which would have resulted if its net utility income had not exceeded a 6½% return" on the rate base (R. I, 57). This left an annual allowance for taxes of $1,068,535 (R. I, 57). The operating revenue

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deductions and exploration and development costs, thus allowed, totaled $7,810,137 for the test year (R. I, 57–58, 68). Deducting this amount from petitioner's operating revenue of $17,360,930 gave $9,550,793 which was $6,393,889 in excess of the 6½% fair return of $3,156,904 (R. I, 69, 58).

To determine the portion of the excess earnings applicable to petitioner's interstate sales for resale, the total cost of service (including a fair return) ($10,845,259) was allocated between such sales and petitioner's other sales (R. I, 59–61). Using the "demand and commodity" method of allocation as applied by the staff, the Commission found $7,264,986 to be the total cost of service (including a fair return) on petitioner's interstate sales for resale (R. I, 61, 69). Since petitioner's revenues from such sales during the test year totaled $12,764,651, the Commission found that petitioner's interstate wholesale rates were "unlawful, unreasonable and excessive" by at least $5,499,665, on the basis of the test year (R. I, 69, 61).

However, the Commission did not require petitioner to reduce its interstate wholesale rates "by the full amount of the excessive return indicated by the test year 1941" (R. I, 63, 69). The Commission took cognizance of the contemplated construction of a pipe line to petitioner's large reserves in the Hugoton field to obtain additional

gas needed by its system (R. I, 61–65).[2] The estimated cost of this line was $15,000,000, on which a 6½% return amounted to $975,000, and depreciation at the rate of 3½% amounted to $525,000, or a total of $1,500,000 (R. I, 63). The $1,500,000 was allocated between interstate sales for resale and other nonregulable sales on the same basis as petitioner's existing transportation system and this resulted in $1,053,794 being assigned to petitioner's interstate sales for resale (R. I, 63). The amount of $1,053,794 was accordingly allowed "as an *additional* cost over and above the reasonable cost of service" (R. I, 64).

The $5,499,665 excess return from petitioner's interstate wholesale sales, less the $1,053,794 of the additional allowance for the proposed Hugoton line allocable to such sales, left $4,445,871, the amount of the rate reduction ordered by the Commission (R. I, 65, 69).

Petitioner, on August 23, 1943, applied for a rehearing and stay of the Commission's order (R. I, 70–71), and, on September 21, 1943, the Commission denied such petition (R. I, 71). Thereafter, a petition for review was filed with the Circuit Court of Appeals for the Tenth Circuit,

[2] The Commission found that "after the lapse of a few years, the Hugoton line, unless other sources of gas closer to the Company's system are discovered, will supply gas to take the place of gas now purchased or produced elsewhere," and that "gas from the Hugoton Field will be substituted for gas now being obtained from other fields, particularly purchased gas" (R. I, 63–64).

which heard oral argument and, on April 30, 1946, Judge Phillips dissenting, affirmed the Commission order (R. III, 1323–1350). A petition for rehearing, filed on July 1, 1946, was denied on July 5, 1946 (R. III, 1354, 1393).

ARGUMENT

In a prolix and repetitious petition and brief in support thereof, petitioner requests this Court again to review various phases of rate regulation questions which this Court has only recently considered and resolved adversely to the very contentions now advanced by petitioner.[3]

We believe that the twenty-one questions which petitioner states as the issues involved (Pet. 3–21) merely set forth sundry aspects of, and are reducible to, the five questions discussed below.

A. *Production and gathering facilities.*—Petitioner seeks to reopen the question of including production and gathering facilities in the rate base and of including expenses of production and gathering in the cost of service—a question which has already been "squarely met and conclusively decided" (R. III, 1328) by this Court in *Colorado Interstate Gas Co.* v. *Federal Power Commission,* 324 U. S. 581. See, also, *Panhandle Eastern*

[3] *Federal Power Commission* v. *Natural Gas Pipe Line Company*, 315 U. S. 575; *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. 591; *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U. S. 581; *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 324 U. S. 635.

Pipeline Co. v. *Federal Power Commission*, 324 U. S. 635, 648; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, 606, *et seq.* Petitioner seeks also to reargue, in a somewhat different guise, the alternative contention rejected in those cases that these facilities should be included in the rate base, if at all, at "fair value."

(1) Petitioner argues (Pet. 6, 47–49) that those cases do not finally determine that production and gathering facilities may be included in the rate base, since it claims they do not represent the views of a majority of this Court.

In this, petitioner is plainly in error, for it is clear from Mr. Justice Jackson's concurring opinion in the *Colorado Interstate* case (324 U. S. at 609), and his joining the majority, rather than the concurring, opinion in the *Panhandle* case (324 U. S. 635, 648–649), that on this point he is in full accord with the prevailing view.[4]

(2) Petitioner also contends (Pet. 8, 51, 55–56) that even if production and gathering facilities may be included in the rate base, the Commission erred in excluding evidence of their fair value, because it says the Commission assumed that it was legally required to act solely upon the basis of actual legitimate cost.

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[4] The concurring opinion in that case rested on the sole ground that the petitioners' objections were not urged in the application for rehearing before the Commission (324 U. S. at 650–651), whereas the majority additionally relied on the propriety of including production and gathering facilities in the rate base (324 U. S. at 648–649).

The Commission's opinion states that the evidence was rejected for the reasons it stated in excluding similar evidence in *Detroit* v. *Panhandle Eastern Pipe Line Company,* 3 F. P. C. 273, 278–280, 45 P. U. R. (N. S.) 203, 208–210 (R. I, 31). The Commission's action in that case was upheld by the Circuit Court of Appeals for the Eighth Circuit (143 F. 2d 488, 492–494), relying on *Pittsburgh Plate Glass Company* v. *National Labor Relations Board,* 313 U. S. 146, and this Court, in granting limited certiorari, refused to review that holding, 323 U. S. 700, 808.

The Commission's factual finding here that "no necessity was shown to exist for the consideration of * * * 'fair value' " (R. I, 66) negatives petitioner's contention that the Commission misconceived the applicable legal criteria, as does the comparison in its opinion of the relative reliability for rate-making purposes of actual legitimate cost, and evidence of "fair value" (R. I, 32).

Moreover, the use of an actual legitimate cost rate base in this case does not differ from its use in the *Hope* (320 U. S. 591), *Colorado Interstate* (324 U. S. 581), *Canadian River* (324 U. S. 581), and *Panhandle Eastern* (324 U. S. 635) cases. Under these cases it is the "end result" which is determinative and the court below correctly applied that test when it treated the economic merits of a rate base as being of no judicial con-

cern and said "we have not the right to intercede unless it is conclusively shown that failure to give consideration to the fair value of properties, including the valuable leasehold estates, will prevent the company from operating successfully as a public utility" (R. III, 1332). Petitioner, as the court below found, has not offered any such evidence (R. III, 1333).[5]

B. *Existing depreciation and depletion.*[6]—The Commission determined the amount of existing depreciation by the "straight-line service life method" (R. I, 43–48) which it usually uses. See, e. g., *Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591, 596–598,

[5] Petitioner compares capital costs of gas produced in various fields with the cost of purchased gas (Pet. 8, 24–26, 57) as though applying the end result test which the Court used in the *Hope* case (320 U. S. 591, 602–605). This obviously misconceives the nature of that test. Moreover, petitioner's comparison fails to reflect the differences in production expense between fields due to differences resulting from variations in rentals and royalties. Such differences in expenses may fully offset any differences in capital costs. The comparison also omits from the figures for the cost of produced gas the expenses of exploration and development, the incurring of which constitutes the risks of that activity, although such risks are, of course, reflected in the cost of the purchased gas. But all those expenses, including all outlays risked in exploration and development, the Commission allowed as revenue deductions which, in effect, the ratepayer bears. The Commission's allowance of $295,439 for such exploration and development costs (R. I, 57, III, 999, 963) is the equivalent, when capitalized at 6½%, of an additional $4,500,000 in the rate base.

[6] Petitioner does not raise any question as to depletion.

606; *Colorado Interstate Gas Company* v. *Federal Power Commission,* 142 F. 2d 943, 959–960 (C. C. A. 10). While not directly attacking this method (cf. R. III, 1334), petitioner contends that the statements of the Commission's engineering witness that he had not personally inspected underground pipe or physically removed pipe from the ground to determine pitting or corrosion (R. I, 450–451) show that the Commission's opinion (R. I, 44) is without support in, and contrary to, the record when it states that a "qualified staff engineer inspected the Company's properties * * *" (Pet. 10).[7]

At most, petitioner is taking issue with only a subsidiary finding, since in the use of the "straight-line service life method," the observance of physical deterioration by inspection is only one of numerous elements taken into consideration (R. I, 427, 551–552, III, 1128–1129). Moreover, petitioner does not base its contention on any claim of inadequacy of the twelve-week field inspection of the above-ground properties

[7] Petitioner's incidental contention (Pet. 61) that there is insufficient evidence to support the Commission's inclusion of $2,200,000 of depreciation on properties acquired from The Kansas City Pipe Line Company, overlooks the evidence that the amount had been accumulated as a depreciation reserve by that company, which the acquiring company had failed to carry onto its books. The Commission merely reclassified this acquisition to show original cost and related depreciation reserve, rather than purchase price. (R. II, 569, III, 984–986.)

(R. I, 428–430, III, 1127–1128). As to the underground pipe, the record shows that among other things, the witness inspected reclaimed pipe and relevant records (R. I, 439, 451, III, 1133) and that he studied some 2020 pipe inspection reports (R. I, 451, 526–527). Such reports gave him substantially the same data (R. I, 550–551) as he could have obtained by the personal inspection which the company's refusal to dig the necessary holes prevented him from making (R. I, 436). From this and other evidence referred to in its opinion (R. III, 1333–1335), the court below rightly concluded that there was sufficient evidence to support the Commission's determination of accrued depreciation.

Furthermore, petitioner's objection goes to the process by which the Commission witness determined service lives and depreciation rates; but petitioner's witness declined to criticize the results reached by that process (R. II, 633–635, I, 43–45). Those rates are presently used by petitioner, on the basis of its own operating experience, for accruing depreciation on its books (R. I, 44, 441–445). And the accrued depreciation computed by the use of those rates is at least $7,500,000 less than petitioner's reserve for depreciation as reclassified (R. I, 41, 46–47, III, 1088).

C. *Profits from extraction operations.*—Gasoline and other residuals are extracted from peti-

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tioner's gas by its affiliate (R. II, 787), Cities Service Oil Company, which pays petitioner only for the loss in the heat value of its gas (R. I, 53, II, 788, 799). Such payments ran from $99,000 to $120,000 a year (R. I, 54), permitting the affiliate to realize an annual profit on this business of some $380,000[8] in excess of a 6½% return (R. I, 55). This excess the Commission treated as a credit to petitioner's operating expenses (R. I, 56), after finding that since the extraction of these residuals renders the natural gas more readily marketable and transportable, consumes a certain volume of the gas, and reduces the heat content, "the gas consumers are entitled to a fair proportion of the net earnings derived from the processing operation" (R. I, 53).

Petitioner contends that the extraction operations are not essential to its natural gas operations and that the Commission erroneously exercised regulatory jurisdiction over the affiliate (Pet. 12). These contentions are without substance.

Here, as in the *Hope* case (134 F. 2d 287, 307–308 (C. C. A. 4), reversed on other grounds, 320 U. S. 591, 594, note 2), extraction of the residuals is so closely associated with petitioner's transportation and sale of natural gas as to be

[8] No allowance for federal income tax was made in computing this figure (Pet. 11, 33, 63) because none was paid by the affiliate (R. III, 1021, note).

a part or a by-product of that business. Cf. *Panhandle* case, 3 F. P. C. 273, 290, affirmed 324 U. S. 635. Operating and marketing conditions are improved as a result of the processing while, on the other hand, some of the natural gas is consumed and the heating value of the remaining gas reduced (R. II, 770, 774, 778, 779).

Petitioner's further contention that the Commission was unlawfully exercising regulatory jurisdiction over the affiliate's gasoline extraction plant, is equally unsound. The Commission did no more than petitioner conceded it had a right to do, i. e., inquire into the reasonableness of the contract between affiliates and make the necessary allowances (Pet. 12, 63). *United Fuel Gas Company* v. *Railroad Commission of Kentucky,* 278 U. S. 300, 319–321. This is no more regulation of the gasoline extraction business than the Commission's use of data relating to production and gathering constitutes regulation of those activities. *Supra,* pp. 10–11. See also, *infra,* p. 19.

To prevent the Commission from so crediting excess profits would enable a regulated gas utility to syphon off profits to nonregulated affiliates by contracting out parts of its business (R. III, 1336), and the same considerations which sustain the disallowance of profits to affiliates are relevant here. In the *Colorado Interstate* case, 324 U. S. 581, 607, this Court affirmed the disallowance of all profits between affiliates in a leasehold transaction and in the *Colorado-Wyom-*

ing case, 142 F. 2d 943 (C. C. A. 10), the circuit court of appeals affirmed the Commission's disallowance of engineering fees paid to an affiliated company. See also *The California Oregon Power Company* v. *Federal Power Commission,* 150 F. 2d 25, 27 (C. C. A. 9), certiorari denied, 326 U. S. 781.

D. *Federal income taxes.*—In determining the amount of federal income tax to be allowed in operating expenses, the Commission computed "the reduction in [petitioner's] Federal income tax which would have resulted if its net utility income had not exceeded a 6½% return" on the rate base (R. I, 57). This reduction aggregated at least $1,882,148, the full amount of petitioner's federal income tax for 1941, the test year, and hence, if petitioner made no more profit on its non-regulable than on its regulable business, there would be no such tax liability to be allocated. As the court below pointed out in approving this treatment: "The Commission did no more than allocate to the non-jurisdictional sales the costs of earnings which were solely attributable to it." (R. III, 1337.)

Petitioner contends (Pet. 14, 67–68) that the Commission disallowed federal income taxes on its non-jurisdictional sales and thereby "regulated" its non-regulable earnings. This contention is analogous to the objections advanced by the companies in the *Canadian River* and *Colorado Interstate* cases. In those cases, it was con-

tended that because the cost of service which the Commission allocated between jurisdictional and non-jurisdictional sales included a 6½% return on "all the property used by petitioners in their various classes of business—intrastate sales, direct industrial sales, and interstate wholesale sales," the Commission thereby limited their non-jurisdictional earnings to a 6½% return. This court rejected that contention. 324 U. S. 581 at 593–594.

While apparently conceding that if it earned no more than 6½% on the over-all rate base, there would be no federal income tax liability, petitioner argues that the Commission's treatment of the tax liability question was inappropriate, and that when properly computed (Pet. 14)[9] a tax liability results which should have been included in cost of service, without recognizing that any such tax liability would be allocable to the non-regulable business.

The rate reduction applies only to the regulable business and should be allocated to that portion of the business solely. When that is done, the soundness of the Commission's action in not allocating any tax liability to the regulable business is demonstrated. The net income of the regulable

[9] Petitioner's computation is erroneous in that the amounts of $380,000 and $65,000 are added to the petitioner's net taxable income. Those amounts represent excess earnings which in fact will remain a part of the income of the affiliated company and cannot be reflected in the income tax return of petitioner.

business ($7,614,407) is roughly 79% of the total net income ($9,550,793) of the entire business.[10] 79% of petitioner's taxable income for 1941 ($6,057,181) is $4,829,390;[11] this represents the taxable income allocable to regulated business, and the corresponding rate reduction ($5,499,665) [12] clearly wipes out that taxable income.[13]

E. *Cost of service allocation.*—As pointed out by the Commission's opinion, petitioner agrees in principle with the so-called "demand and commodity" method used by the Commission of allocating costs of service between its interstate sales for resale and its other, nonregulable sales (R. I, 60). It contends, however, that "there are

[10] The total net income, $9,550,793, is derived by subtracting the cost of service excluding return, $7,688,355, from total gas revenues, $17,239,148 (R. I, 52, note 34). The cost of service excluding return, $7,688,355, is arrived at by subtracting return, $3,156,904 (R. I, 57, note 41), from cost of service, $10,845,259 (R. I, 61).

The net income of the regulable business, $7,614,407, is derived by subtracting cost of service excluding return allocable to regulable business, $5,150,244, from regulable gas revenues, $12,764,651 (R. I, 61). The cost of service excluding return allocable to regulable business, $5,150,244, is arrived at by multiplying the cost of service excluding return, $7,688,355 (above), by the ratio between the cost of service including return allocable to the regulable business, $7,264,986 (R. I, 61) and the total cost of service including return, $10,845,259 (R. I, 61).

[11] See following footnote.

[12] Additional allowance for expense of Hugoton gas, $1,053,794 (R. I, 64), should be deducted from each of these figures; however, the result would be the same.

[13] Statutory tax deductions would relieve petitioner of income tax liability even though for rate purposes it earned a 6½% return.

no Commission findings of fact disclosing the governing 'considerations of fairness' or what 'judgment' factors entered into the adoption of 'the staff's method' " (Pet. 16.)

This is the same contention which was raised in cognate circumstances and, after careful consideration, rejected by this Court in the *Canadian River* and *Colorado Interstate* cases (324 U. S. 581, 586–595). Here, as in those cases, the Commission adopted its staff's method without change [14] and hence the Commission's findings read together with the exhibits setting forth the staff's method are sufficiently detailed so that "the path which it followed can be discerned" and is not "so vague and obscure as to make the judicial review contemplated by the Act a perfunctory process" (324 U. S. at 595), although the case was tried and decided prior to those decisions and prior to the decision in the *Colorado-Wyoming* case (324 U. S. 626). The latter was a clearly different case, since there the method of allocation adopted in the Commission's findings departed from its staff's method, and as a result there were ambiguities in the record which this Court was unable to resolve, were it its province to do so (324 U. S. at 632).

[14] The Commission stated in its opinion (R. I, 61), that "Applying the staff's method of allocation, we find that $7,264,986 represents the total cost of service (including a fair return) for the sales subject to our jurisdiction, and $3,580,273 represents the cost of service for the sales not subject to our jurisdiction."

CONCLUSION

The decision below is correct and fully accords with the decisions of this Court in the *Hope, Colorado Interstate* and *Panhandle Eastern* cases. There is no conflict of decisions. We respectfully submit that the petition for a writ of certiorari should be denied.

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OCTOBER 1946.

APPENDIX

The pertinent provisions of the Natural Gas Act of 1938, c. 556, 52 Stat. 821, 15 U. S. C. 717, *et seq.*, are as follows:

SECTION 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

* * * * *

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission,

and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public

inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided,* That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference

thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or

contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

SEC. 6. (a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Every natural-gas company upon request shall file with the Commission an

inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

* * * * *

SEC. 9. (a) The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. No natural-gas company subject to the jurisdiction of the Commission shall charge to operating expenses any depreciation or amortization charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation or amortization other than that prescribed therefor by the Commission. No such natural-gas company shall in any case include in any form under its operating or other expenses any depreciation, amortization, or other charge or expenditure included elsewhere as a depreciation or amortization charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-

gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges.

(b) The Commission, before prescribing any rules or requirements as to accounts, records, or memoranda, or as to depreciation or amortization rates, shall notify each State commission having jurisdiction with respect to any natural-gas company involved and shall give reasonable opportunity to each such commission to present its views and shall receive and consider such views and recommendations.

* * * * *

SEC. 14. (a) The Commission may investigate any facts, conditions, practices, or matters which it may find necessary or proper in order to determine whether any person has violated or is about to violate any provision of this act or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this act or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation to the Congress. The Commission may permit any person to file with it a statement in writing, under oath or otherwise, as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish in the manner authorized by section 312 of the Federal Power Act, and make available to State commissions and municipalities, information concerning any such matter.

(b) The Commission may, after hearing, determine the adequacy or inadequacy of the gas reserves held or controlled by any natural-gas company, or by anyone on its behalf, including its owned or leased properties or royalty contracts; and may also, after hearing, determine the propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases. For the purpose of such determinations, the Commission may require any natural-gas company to file with the Commission true copies of aii its lease and royalty agreements with respect to such gas reserves.

* * * * *

SEC. 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and

matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

* * * * *

SEC. 19. (a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon.

(b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within

sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modi-

fication or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

(c) The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

U. S. GOVERNMENT PRINTING OFFICE: 1948

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 556.

CITIES SERVICE GAS COMPANY, a Corporation,
Petitioner,

v.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; the CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; and CORPORATION COMMISSION OF THE STATE OF OKLAHOMA,
Respondents.

MOTION OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA FOR LEAVE TO FILE A BRIEF, AMICUS CURIAE, IN SUPPORT OF THE PETITION OF CITIES SERVICE GAS COMPANY FOR REHEARING OF DENIAL OF WRIT OF CERTIORARI, AND BRIEF, AMICUS CURIAE.

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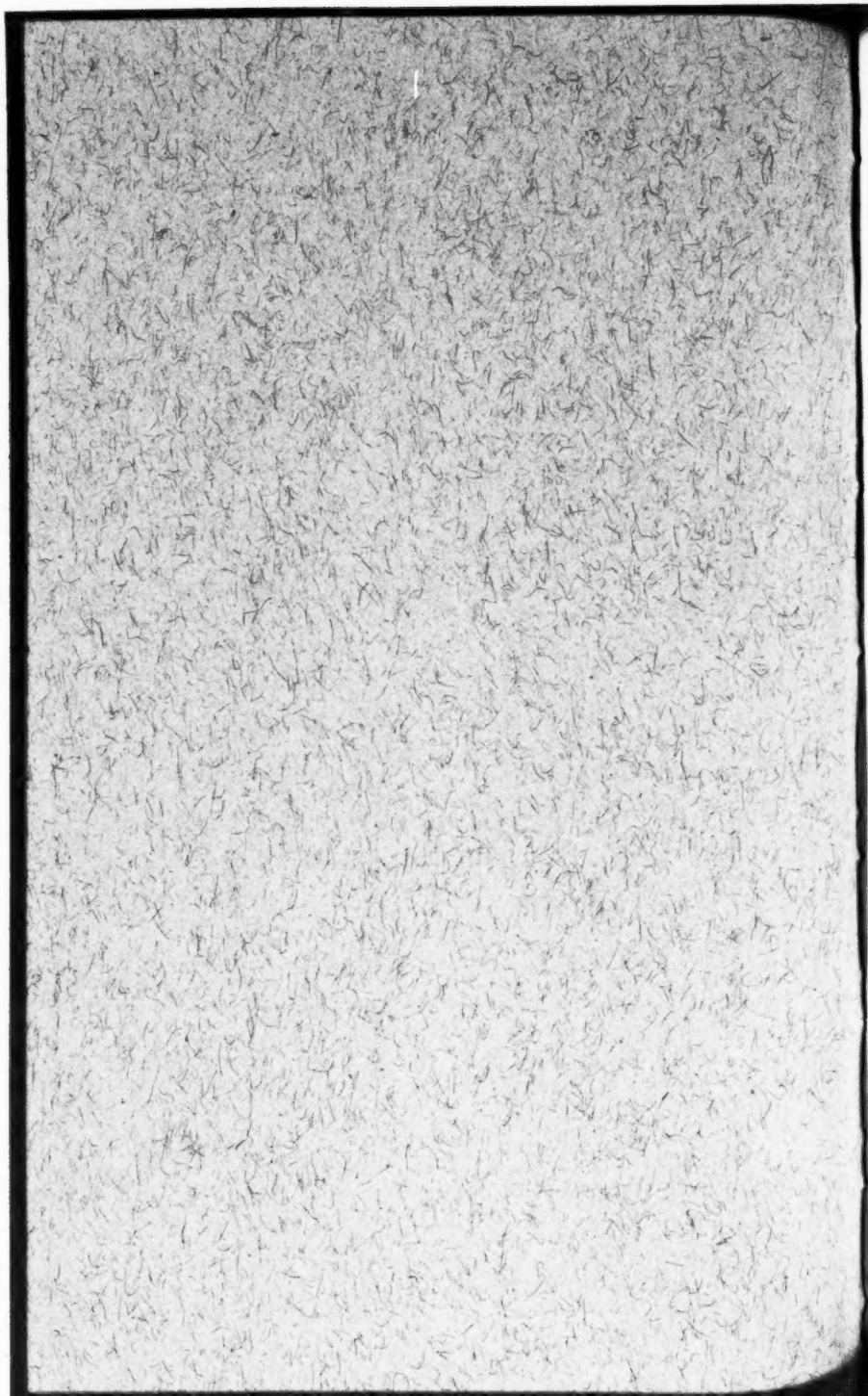

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Respondents.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

MAY IT PLEASE THE COURT:

The undersigned, as counsel for the Independent Natural Gas Association of America, respectfully moves this Honorable Court for leave to file the accompanying brief in the case as Amicus Curiae. The Solicitor General of the United States, speaking for the Federal Power Commission, Respondent, and Cities Service Gas Company, Petitioner, the parties in legal interest in the record, have consented to the filing of brief by this applicant as Amicus Curiae. The consent of all other parties has been obtained except the City of Kansas City, Missouri, which has refused to accord its consent.

WESLEY E. DISNEY,
General Counsel
Independent Natural Gas Association of America.

IN THE

Supreme Court of the United States

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Respondents.

BRIEF OF THE INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, AMICUS CURIAE, IN SUPPORT OF THE PETITION OF CITIES SERVICE GAS COMPANY FOR REHEARING OF DENIAL OF WRIT OF CERTIORARI.

PRELIMINARY STATEMENT.

This brief is submitted on behalf of the Independent Natural Gas Association of America, a private corporation organized and existing under the laws of the State of Delaware. It has a membership of approximately 1600, located in 23 different states, including all natural gas producing states and most of the natural gas consuming states. Its membership includes producers, royalty owners, transporters (intrastate and interstate), natural gas companies

under the Act, public members and consumer members. It will thus be seen that its membership includes representatives of all groups interested in the production, transportation and use of natural gas.

Since the passage of the Natural Gas Act this Court has exercised its discretion on certiorari by taking jurisdiction and deciding a number of cases arising under the Act.[1]

In these several cases, however, this Court, in most instances, limited its review to certain specific questions, the result being that up to this time the Court has not passed upon some of the most important questions involved in the construction and administration of the Natural Gas Act. The fact that this Court has on so many occasions since the comparative recent passage of the Natural Gas Act taken jurisdiction over questions involving that Act indicates that this Court recognizes the public importance of such questions as justification for certiorari and convinces us that in denying the Petition for Writ of Certiorari by the Cities Service Gas Company in this case the Court has overlooked or not fully comprehended the character and importance of the questions presented.

SUMMARY STATEMENT.

In this case Cities Service Gas Company in its Petition for Writ of Certiorari presented eight separate and distinct questions. By its judgment of November 12, 1946, this

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[1] *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575; 62 S. Ct. 736.
Federal Power Commission v. *Hope Natural Gas Co.*, 320 U. S. 591; 64 S. Ct. 281.
Colorado Interstate Gas Co. v. *Federal Power Commission*, 324 U. S. 581; 65 S. Ct. 829; 89 L. Ed. 1206.
Canadian River Gas Co. v. *Federal Power Commission*, 324 U. S. 581; 65 S. Ct. 829; 89 L. Ed. 1206.
Colorado-Wyoming Gas Co. v. *Federal Power Commission*, 324 U. S. 626; 65 S. Ct. 850.
Panhandle Eastern Pipe Line Co. v. *Federal Power Commission*, 324 U. S. 635; 65 S. Ct. 821.

Court denied the Petition as to all questions presented. We understand that Cities Service Gas Companf has filed or shall file its Petition for Rehearing as to all eight of the questions by it presented in its Petition for Writ. A decision on all eight questions contained in the Petition for Writ is, in our opinion, necessary for a proper determination of the jurisdiction of the Federal Power Commission under the Act and the administration thereof and the conduct of the great and growing natural gas industry and the consuming public.

Without in any way minimizing and still suggesting the importance of all eight questions involved, but leaving the presentation of all but two of the presented points to others on this rehearing proceeding, we will limit our presentation and argument to two only of the eight questions presented in the Petition for Writ; namely, Questions numbered 2 and 3. Briefly stated, these questions involve the following:

> QUESTION No. 2: Regulatory Jurisdiction of the Federal Power Commission over the Production and Gathering of Natural Gas
>
> QUESTION No. 3: Do the Previous Decisions of this Court Involving Cases Under the Natural Gas Act Either Directly or By an Application of the "End Result" Theory Authorize the Commission to Exclude all Evidence of Market Value of Natural Gas Leaseholds and Ground the Rate Base as to Such Leaseholds Solely Upon the Original Cost Thereof?

As to these two questions, the Court of Appeals in its opinion to which this Petition for Writ is directed [2] has upheld a Federal Power Commission rate reduction order, as we read and interpret its opinion, upon the sole ground that it is foreclosed from exercising its own independent judicial function by one or more of the opinions of this Court in the several cases hereinabove referred to pre-

[2] *Cities Service Gas Co.* v. *Federal Power Commission, et al.*, 155 Fed. (2d) 694.

viously decided by this Court.[1] If the Court of Appeals is in error in this conclusion, then we submit that the Petitioner, Cities Service Gas Company, must necesasrily be right in its arguments herein advanced that it has been deprived of the judicial review and protection to which it is entitled under the Constitution and under Section 19(b) of the Act. Again, if the Court of Appeals is incorrect in concluding that it is so foreclosed by this Court's previous opinions and this Court shall allow the opinion and judgment of the Court of Appeals to stand by denial of the Petition for the Writ of Certiorari, a precedent is set for all practical purposes which will control the natural gas industry and its relations with the Government through the Federal Power Commission and with the consuming public. These questions do not involve merely the particular litigant in this case.

We are frank to say that we know of no case in which these important questions are more forcibly and strikingly presented and are more apt for decision by this Court than in this *Cities Service* case. We venture to state that the questions are of such importance and will be presented so often from time to time they must necessarily at some time be decided, and even if consideration of the particular litigant at bar be ignored, the public importance of the questions presented we believe justifies their consideration and determination by this Court at this time.

While arguments in support of the two questions to which this brief is directed can and will no doubt be presented from different viewpoints, it is our purpose, as above stated, to point out that the affirmance by the Court of Appeals of the Commission's rate reduction order in this case is erroneous because grounded upon an erroneous conception of the law, in that, as to these points at least, the affirmance of the Commission's order is entirely based upon the conclusion that the applicable law had been definitely settled by the previous decisions of this Court.

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[1] See cases cited in footnote, page 4 of this brief.

That the Court of Appeals was wrong in this construction of the previous decisions of this Court and consequently the Petitioner, Cities Service Gas Company, has been denied the judicial review to which it is entitled by the Constitution and the Act and therefore the order of the Commission and the affirming judgment of the Court of Appeals should not be permitted to stand without the consideration and determination by this Court, is the scope of the following argument which we will present in as brief a manner as possible.

ARGUMENT.

Question No. 2.

Regulatory Jurisdiction of the Federal Power Commission Over the Production and Gathering of Natural Gas.

This involves the question of the proper interpretation of Section 1(b) of the Act which expressly provides that its provisions "shall not apply * * * to the production or gathering of natural gas." The Commission in this *Cities Service* case, notwithstanding this provision of the Act, avowedly exercised rate-regulatory jurisdiction over the production and gathering properties of the Cities Service Company. The Court of Appeals held that the Commission had such jurisdiction [3] and based this conclusion upon the opinions of this Court in the *Colorado Interstate* and *Canadian River* cases.[1] The Court of Appeals called attention to the several opinions of this Court on this question and concluded: "It is thus clear that under the prevailing view, the Commission did not exceed its jurisdiction by the inclusion of the production and gathering facilities in the rate base for purposes of determining just and reasonable rates for the transportation for resale of natural gas" (155 Fed. (2d) 700).

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[1] See cases cited in footnote, page 4 of this brief.

[3] 155 Fed. (2d), pp. 699-700.

We respectfully submit that there is no prevailing opinion of this Court outstanding at this time holding that the Commission has rate-regulatory jurisdiction over production and gathering. In the *Canadian River* case this Court took jurisdiction on certiorari of that question. Three opinions were written. Five members of this Court, for divergent reasons, were in favor of an affirmance of the judgment of the Court of Appeals and the Commission's order involved in that case, so the judgment of the Court of Appeals affirming the Commission order involved in that case was affirmed by this Court.

Mr. Justice Douglas wrote one opinion in the *Canadian River* case in which Justices Black, Murphy and Rutledge joined. These four Justices held that the Commission does have rate-regulatory jurisdiction over production and gathering.

Mr. Chief Justice Stone wrote a dissenting opinion, joined in by Justices Roberts, Reed and Frankfurter, holding that the Commission did not have such jurisdiction over production and gathering.

Mr. Justice Jackson wrote a special concurring opinion in which he agreed on an affirmance of the judgment of the Court of Appeals, but in his special concurring opinion he likewise held that the Commission did not have rate-regulatory jurisdiction over production and gathering. His affirmance as to this point was based upon the theory that the Commission in that case had not exercised prohibited rate-regulatory jurisdiction over production and gathering.

As we analyze the Canadian River opinions, therefore, this Court has held by five to four that the Commission does not have rate-regulatory jurisdiction over production and gathering. It seems clear to us, therefore, that the Court of Appeals in this *Cities Service* case has grounded its judgment upon an obvious misconception of the ruling of this Court in the *Canadian River* case. The most that possibly could be said of the *Canadian River* case is that the Court divided four to four on this jurisdictional ques-

tion, with Mr. Justice Jackson voting an affirmance on entirely different grounds. This Court has only recently held in the case of *United States* v. *Pink* that "* * * The lack of an agreement by a majority of the court on the principles of law involved prevents it (the decision) from being an authoritative determination for other cases."[4] There was, therefore, we submit, no legal justification for the Court of Appeals in the *Cities Service* case concluding that it was bound by a decisive precedent of this Court on this jurisdictional question. Having based its judgment upon this erroneous concept of the law claimed to have been established by this Court, the judgment of the Court of Appeals should not be permitted to stand in the light of the opinion of this Court in *Connecticut L. & P. Co.* v. *Federal Power Commission*,[5] in which this Court directly held that a Commission order could not stand and must be reversed because it had not proceeded under a correct rule of law.

Question No. 3.

Do the Previous Decisions of This Court Involving Cases Under the Natural Gas Act Either Directly or by An Application of the "End Result" Theory Authorize the Commission to Exclude All Evidence of Market Value of Natural Gas Leaseholds and Ground the Rate Base as to Such Leaseholds Solely Upon the Original Cost Thereof?

The Commission, in its assumption of rate-regulatory jurisdiction over production and gathering facilities of Cities Service Gas Company, excluded all evidence of the fair or market value of thousands of acres of natural gas leaseholds and grounded its rate base, so far as the leaseholds are concerned, entirely upon the original cost thereof. As shown by the brief of Cities Service Gas Company in

[4] *United States* v. *Pink*, 315 U. S. 203; 62 S. Ct. 552.
[5] 324 U. S. 515; 65 S. Ct. 749.

support of its Petition for the Writ, the effect of this was to include a large acreage at no value and most of the remaining acreage at a nominal value.

The Court of Appeals sustained the Commission in this action (155 Fed. (2d), p. 700). The Court of Appeals felt bound to sustain the Commission in this respect because of its interpretation of this Court's opinions in the *Canadian River* and *Panhandle Eastern* cases. In its majority opinion (pp. 701, 702) the Court of Appeals states:

> "* * * In support of certiorari, the Canadian River Gas Company, as the owner of the properties devoted to the integrated enterprise, strenuously complained of the refusal of the Commission to include the producing properties in the rate base at the cash sale price paid by the company first devoting them to public use. That point was taken on certiorari, 323 U. S. 807, 65 S. Ct. 427, 89 L. Ed. 644, and specifically treated on appeal. 324 U. S. at page 604, 65 S. Ct. at page 840, 841, 89 L. Ed. 1206. The majority of the court could not 'say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost.' 320 U. S. at page 605, 65 S. Ct. at page 841, 89 L. Ed. 1206. But see Mr. Justice Jackson concurring, 320 U. S. at page 610, 65 S. Ct. at page 843, 89 L. Ed. 1206, and dissent of the late Mr. Chief Justice Stone, 320 U. S. at page 616, 65 S. Ct. at page 845, 89 L. Ed. 1206. A like contention was made and rejected in Panhandle Eastern Pipe Line Co. v. Federal Power Commission, 324 U. S. 635, 648, 65 S. Ct. 821, 89 L. Ed. 1241.
>
> In view of these pronouncements, we regard the question no longer a debatable one in this court. * * *"

We again submit that the Court of Appeals has misconstrued the opinion of this Court.

In the *Canadian River* case the Commission did actually receive in evidence and consider both original cost and present fair value of the natural gas leaseholds involved, and then included the leaseholds in the rate base at original cost. In the opinion of Mr. Justice Douglas, joined in

by three other Justices, this Court approved the action of the Commission in this respect upon the ground previously announced in the *Natural Gas Pipeline* and *Hope* cases that the Commission is not bound to use any single formula in determining rates.

In the present *Cities Service* case the Commission excluded all evidence of fair value of the leaseholds and so made it impossible to give consideration to fair value in determining which formula it should use in arriving at the rate base.

We believe no case has been submitted to this Court in which all evidence of fair value was actually excluded by the Commission.

In the *Canadian River* case four members of this Court, in the opinion written by Mr. Chief Justice Stone, held that the Commission did not have rate-regulatory jurisdiction at all over production and gathering, so clearly these four Justices have not approved the inclusion of natural gas leaseholds in a rate base at original cost, or at all.

Mr. Justice Jackson, in his special concurring opinion in the *Canadian River* case, in most strong language, disapproved the inclusion of natural gas leaseholds in a rate base at original cost, and joined in an affirmance of the Commission's order involved in that case only upon the "end result" theory, which theory he also disapproved but felt bound to follow because of previous decisions of this Court.

We again submit, therefore, that as to this question, in so far as the *Canadian River* case is involved, there is no opinion by a majority of this Court holding it proper to reject all evidence of fair value of natural gas leaseholds in arriving at a rate base and grounding the rate base "as a matter of law" entirely upon original cost. In fact, again as we construe the *Canadian River* opinions, a majority of the Court has held to the contrary.

In concluding his discussion of this question in the *Canadian River* case Mr. Justice Douglas said (p. 605, U. S.):

> "Hence, we cannot say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost. That could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case."

It will thus be seen that all that was said in this connection even by Mr. Justice Douglas and his three associates who joined in his opinion, was that it was not erroneous as a matter of law, after considering evidence of fair value, to use the original cost formula in the rate base.

It will also be noted that the reason assigned for this conclusion was "That could be determined only on consideration of the *end result* of the rate order, *a question not here under the limited review granted the case.*" (Italics supplied.)

In the *Canadian River* case the "end result" of the rate reduction order therein involved, including the inclusion of the leaseholds there involved at original cost, was tendered to this Court as a point for consideration on certiorari, but this Court refused to grant certiorari on the "end result" point, as indicated by Mr. Justice Douglas. It will thus be seen that this Court did not in the *Canadian River* case (and has not in any other case to our knowledge) decide or consider the propriety or legality of excluding all evidence of value of leaseholds and including the leaseholds in the rate base at original cost when viewed in the light of the "end result."

When the Court of Appeals, therefore, in the *Cities Service* case grounded its affirmance of the Commission's order upon the premise that the right of the Commission to include natural gas leaseholds in a rate base at original cost, even going to the extent of excluding all evidence of fair value, was no longer a debatable question, and in reliance thereon cited the *Canadian* case, we submit the Court committed grievous error. As we have pointed out above,

this Court, in the *Canadian* case, did not so decide. Viewing the three separate opinions of this Court in the *Canadian* case, it would seem that this Court has decided just to the contrary. Four Justices directly held that the Commission had no rate-regulatory jurisdiction at all over production and gathering. Four Justices held that it did have such jurisdiction and that it had properly exercised that jurisdiction if the "end result" of such inclusion be ignored, which the Court proceeded to ignore because it had not granted certiorari on that particular issue. Then Mr. Justice Jackson, while reluctantly affirming the Commission's opinion and the affirmance of the Court of Appeals thereof upon the "end result" theory because he felt bound to do so until a majority of the Court should change the "end result" theory as announced in the *Hope* case, affirmed the Commission's order on the "end result" theory.

The theory of "end result" or "impact of the rate order" is the predominating principle which this Court promulgated and is applying to these natural gas cases. The Court expressly refused to grant certiorari on this "end result" or "rate impact" question when tendered to it in the *Canadian* case. It has not considered or decided the "end result" question in any case when applied to the inclusion of natural gas leaseholds in a rate base at original cost. The application of this "end result" theory to this question is obviously a most important question. The effect of the inclusion of natural gas leaseholds at zero value or nominal value and the allowance of a rate of return upon that zero value or nominal value as applied to the Cities Service situation is most forcibly pointed out in the brief of Cities Service Gas Company supporting its Petition for the Writ.

Mr. Justice Jackson, in his special concurring opinion in the *Canadian River* case, reiterated the views he had expressed in the *Hope* case that the entire rate-base method

should be rejected in pricing natural gas. He referred to this method as producing "delirious" results and "capricious" results. He called the method a "fantastic" method. He felt bound, however, by the "end result" theory announced by a majority of the Court in its previous cases, stating: "I think, however, that the majority which promulgated that decision (*Hope*) should be permitted to continue to spell out its application to specific problems until we see where it leads."

But this Court in this *Cities Service* case has refused so far to grant certiorari on this "end result" or any other question for the purpose of considering and determining where its application does lead as applied to the Cities Service situation.

We suggest that if the "end result" or "rate impact" theory is to continue to be the controlling applicable principle, then this Court should not continue to refuse to grant certiorari on that question as it did in the *Canadian* case.

The Court of Appeals also cited the *Panhandle Eastern* case [1] in support of its conclusion that under the decisions of this Court the right to include natural gas leaseholds in a rate base at original cost and the right to exclude all evidence of fair value was no longer a debatable question.

In this again we submit the Court of Appeals is in error.

The affirming judgment of this Court in the *Panhandle Eastern* case, as in the *Canadian River* case, was by a divided court. The Panhandle Eastern, in its brief before this Court, raised the question of jurisdiction of the Commission over production and gathering and the question of inclusion of natural gas leaseholds in the rate base at original cost, and there is some discussion of this question in the opinion of Mr. Justice Douglas (324 U. S., pp. 648-649). However, this discussion, in substance, merely refers to the opinion of Mr. Justice Douglas in the *Canadian River* case, and then concludes with the statement that in any event Panhandle Eastern was barred from raising these questions

in this Court because it had not raised them in its application for rehearing before the Commission. Clearly, therefore, the Panhandle Eastern decision, even without considering the dissenting opinion of Mr. Justice Stone and Justices Roberts, Reed and Frankfurter, establishes no prevailing rule of this Court that the Commission has rate-regulatory jurisdiction over production and gathering, or, even assuming such rate-regulatory jurisdiction, that it is proper, with or without applying the "end result" doctrine, to include natural gas leaseholds in the rate base at original cost or to exclude all evidence or consideration of fair or market value of the leaseholds in determining what formula should be used in arriving at the rate base.

We have again pointed out that the Court of Appeals on this question has grounded its affirmance of the Commission's rate reduction order upon an erroneous theory of law and upon a misapplication of the decisions of this Court. This being so, then under the rule announced by this Court in *Connecticut L. & P. Co.* v. *Federal Power Commission*,[5] the affirming judgment of the Court of Appeals is necessarily erroneous.

CONCLUSION.

While the granting of certiorari is a matter of judicial discretion, we respectfully submit that in view of the public importance of the questions presented and the special important reasons for certiorari in connection therewith hereinabove pointed out, and the fact that Federal questions of substance are presented which have not heretofore been determined by this Court but have been decided by the Court of Appeals in a way (not merely probably) but clearly not in accord with the applicable decisions of this Court, the discretion of this Court under its Rules should be exer-

[5] 324 U. S. 515; 65 S. Ct. 749.

cised in favor of granting the Petition for the Writ, at least as to the questions above outlined.

Respectfully submitted,

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA,

WESLEY E. DISNEY,
Southern Building,
Washington, D. C.
General Counsel.

LAWRENCE H. GALL,
Southern Building,
Washington, D. C.,
of Counsel.

No. 556

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

CITIES SERVICE GAS COMPANY, a corporation, *Petitioner*,

v.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; the CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; and CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, *Respondents*.

On Petition for Rehearing on the Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF AMICUS CURIAE ON THE PETITION FOR REHEARING OF

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA, AMICUS CURIAE.

RUSSELL B. BROWN,
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Washington, D. C.

December 7, 1946.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

SUBJECT INDEX.

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

The Independent Petroleum Association of America, by its General Counsel, moves this Honorable Court for leave to file, as *amicus curiae,* the accompanying brief on the petition for rehearing filed herein. The written consent of all the parties to this proceeding, with the single exception of the City of Kansas City, Missouri, which is not an original party hereto, have been obtained.

Respectfully submitted,

RUSSELL B. BROWN,
General Counsel,
Independent Petroleum
Association of America.

IN THE

Supreme Court of the United States

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On Petition for Rehearing on the Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

BRIEF ON THE PETITION FOR REHEARING.

This brief of the Independent Petroleum Association of America is presented *amicus curiae*, under Rule 27, paragraph 9, of the Rules of the Court.

The judgment of this Court denying the petition for writ of certiorari was entered herein on November 12, 1946. This brief is in support of the petition for rehearing.

PRELIMINARY STATEMENT.

The Independent Petroleum Association of America (hereinafter referred to as IPAA) is a corporation organized and existing under the laws of the State of Oklahoma.

The IPAA is a national association of independent producers of crude petroleum and natural gas, independent refiners of petroleum, independent transporters of crude petroleum or its products or natural gas through pipe lines, owners of oil or gas royalties, land owners, permit holders, drilling contractors, and independent distributors of petroleum products or natural gas. Every oil and gas producing state of the nation is represented in the membership of the Association.

The IPAA, the membership of which as above stated includes, inter alia, producers of natural gas and royalty and land owners of natural gas, has a direct and immediate interest in this proceeding. And its interest is not confined to its members concerned solely with natural gas. The interest of IPAA stems from each and every one of its approximately 6,000 members whether concerned with *gas* or *oil*. The oil industry, being so inherently related chemically, physically and geologically to the gas industry, also directly and immediately is concerned. Due to this inherent relationship of the *oil* and *gas* industries, any action affecting the "production or gathering" of one necessarily and inescapably extends back into or affects the other. It follows therefore that the entire membership of IPAA is affected and interested. And theirs is not a passive interest. Only recently the membership, in their seventeenth annual meeting held in Fort Worth, Texas, October 28–30, 1946, had occasion to consider and take overt formal action on the specific issues argued in this brief. The contentions advocated herein strictly conform to the action so taken by the membership. And this interest and concern on the part of the membership of the IPAA is not an incipient one. It is one that has developed through vigilant surveillance of the administration of the Natural Gas Act since its enactment. In the first case (1940), viz, The Columbian Fuel Corporation Case,[1] before the Commission in which was presented the issue argued herein relative to "production

[1] Columbian Fuel Corporation, 2 FPC 200, 35 P.U.R. (N. S.) 3.

or gathering", the IPAA participated. Since that case the IPAA on several occasions has considered its interests as affected by the administration of the Natural Gas Act and has culminated such considerations in its recent action at its seventeenth annual meeting referred to above.

It is submitted, therefore, that the IPAA has a material and very substantial interest in the adjudication of the issues presented in this proceeding.

STATEMENT OF THE CASE.

The decision of the Court of Appeals below presents to the Court the following circumstances which are dealt with herein and are submitted as compelling reasons why the writ for certiorari should be granted.

1. A new and novel issue not heretofore before this court involving the jurisdiction and applicability of a Federal statute. (See "SUMMARY OF ARGUMENT" Page 16)

2. Existing uncertainty and confusion resulting from the administration of the law (a federal statute) and the decisions of the courts demand the attention of this Court. (See "REGULATION OF PRODUCING AND GATHERING OF NATURAL GAS," Page 9)

3. The fears and hallucinations of the Court of Appeals below have prescribed the jurisdictional limits of the law involved rather than the plain language of Congress. (See "EXERCISE OF AUTHORITY OVER THE CITIES SERVICE OIL COMPANY", Page 14)

4. The decision of the Court of Appeals below sanctions a capricious and flaunting disregard of the intent, purpose and scope of the law. (See "EXERCISE OF AUTHORITY OVER THE CITIES SERVICE OIL COMPANY", Page 14)

5. The decision of the Court of Appeals below, if permitted to stand, will change the entire economic base on which the oil and gas industries have been built. (See Page 8)

6. The decision of the Court of Appeals below, if permitted to stand, would be to permit an errant court

to give effect to the grasping impulse of an over-ambitious bureau which unchecked, changes our form of Government without legislative sanction and in direct conflict with legislative expression. (See Page 8)

This proceeding involves the validity of an order of the Federal Power Commission (hereinafter referred to as the Commission), entered on July 28, 1943, requiring the Cities Service Gas Company (hereinafter referred to as Petitioner) to reduce its rates for the transportation and sale of natural gas. The rate base from which the reduction was determined included, inter alia, the production and gathering facilities of the Petitioner and, in addition, the Commission also exercised regulatory authority over the natural gasoline extraction plants of Cities Service Oil Company, an affiliate of but a separate operating and corporate entity from the Petitioner.

The decision of the Court of Appeals below insofar as it goes in upholding as properly within the jurisdiction of the Commission the producing and gathering properties and facilities of the Petitioner, has found support from some quarters on the premise that the Petitioner otherwise is a "natural gas company" and subject to the jurisdiction of the Commission. If this decision below or the pertinent decisions of this Court were clear and precisely to this end then those in the producing and gathering phase of the oil and gas industries who are *not* otherwise a "natural gas company" and therefore not subject to the jurisdiction of the Commission, could take solace in such jurisdictional limitation. But the opinion below does not stop there. The opinion below as an analysis clearly reveals, is an outright and complete repudiation of the Congressional mandate prescribing the exemption of "production or gathering." The opinion below does not stop with the inclusion, within the sanctioned jurisdiction of the Commission, of the "producing and gathering" properties of the Petitioner but, in addition, the opinion below reaches out and breaches all jurisdictional limitations and grasps the property of a separate corporate entity which clearly and ad-

mittedly is not otherwise a "natural gas company." Wherein then can *any* oil or gas producer or gatherer, or driller, or land owner, or royalty owner, or transporter, or refiner or processer, even though he is *not* "otherwise a natural gas company", who has any relationship or dealings whatever with a "natural gas company", find escape from the usurping authority of the Commission. This is a step by step by step creeping process whereby the Commission, with the sanction of the courts, is extending its jurisdiction into forbidden fields. Viewed in light of the clear, unequivocal and precise legislative limitations prescribed in the Act this is jursdictional extension on the rampant. This is the process which is the cause of the fear which already has manifested itself within the oil and gas industries. Producers refuse to contract for sale of gas lest they be declared "natural gas companies" or for other reason declared subject to the jurisdiction of the Commission. The economic results of this process of the Commission is compelling producers and processors to "flare" their gas so as to avoid the destructive effects of being subjected to the Commission's jurisdiction. This course not only compels waste but destroys incentive to develop the oil and gas resources vital to our peacetime as well as wartime economy. And this process is being permitted to continue at a time when incentive should be its highest, when every individual effort is imperative not only to reconvert a war-worn economy but as is so earnestly and persistently advocated from so many quarters of our government, to prepare our economy for another not improbable emergency. Yet, here the Court of Appeals below has sanctioned a process whereby the Commission has exercised (1) rightful or proper jurisdiction over the "natural gas company" activities of Petitioner, plus, (2) improper or wrongful jurisdiction over the "production and gathering" activities of the Petitioner which activities are specifically exempted from the Natural Gas Act, plus (3) improper and wrongful jurisdiction over a stranger party to the rightful issues involved, viz., the Cities Service Oil Company. The founda-

tional danger lies within the accumulation of jurisdiction embodied within this triple headed jurisdictional malformation. Each of the three parts of this malformation taken separately, and even though afoul of the legislative intent, are bounded by at least some limitations. Together they create a limitless jurisdiction. Together they make entirely meaningless the specific exemption set forth in Section 1 (b) of the Natural Gas Act with respect to "production or gathering."

The practical effect of permitting the opinion of the lower court to stand would be to change the entire economic base on which the oil and gas industries of the United States have been built, from one of free economy to bureauracy control. An errant court has given effect to the grasping impulse of an over ambitious bureau which unchecked, changes our form of Government without legislative sanction and in direct conflict with legislative expression. A process with these earmarks cannot be tolerated under our form of government. It must be stopped. It is now appropriate for this Court to exercise judicial correction. It is to this end that this brief is addressed.

It is submitted that the above is a summary of the fundamental jurisdictional questions presented by this cause together with a cursory reference to the profound economic aspects of the issues.

ARGUMENT.

The issues to be argued in this brief are raised by Petitioner's Questions No. 2, No. 3 and No. 5.[1] The specific issues dealt with herein briefly may be summerized as follows:

I. Regulation of Production and Gathering of natural gas, including the related issues of (a) the impropriety of applying the public utility theory of rate-making to the production and gathering phase of the natural gas industry, and (b) the impropriety of the "cost" method of evaluation applied by the Commission,

[1] See Petition for Writ of Certiorari, Pages 6, 7 and 11.

II. Exercise of Authority over the Cities Service Oil Company.

These issues herein will be argued separately to the conclusion that the Court of Appeals below has erred in its decision with respect to each separately. The more important and overriding question presented to this Court, however, evolves from the joint results and effects of the decision below on these separate issues. These issues taken jointly, under the decision below, vitiate in their entirety the legislative prohibitions excluding "production or gathering" from the Commission's jurisdiction. Section 1 (b) of the Natural Gas Act thereby is voided.

This "Argument" is designed to supplement the Petitioner's presentation of the issues involved. The confinement of this argument to the issues enumerated above does not mean that the IPAA is not in sympathy with the other questions raised by Petitioner or that such questions do not present profound issues which warrant review by this Court. On the contrary these other issues involve the fundamental right and true meaning and scope of "judicial review" and other matters of substantive importance to the oil and gas industries.

I. Regulation of Production and Gathering of Natural Gas.

The Commission in this proceeding included all the production and gathering properties and facilities of the Petitioner in the rate base upon which its rate reduction order was founded. This procedure presents three issues: (1) The legal interpretation of the language of the Natural Gas Act in order to determine the jurisdiction, if any, conferred upon the Commission over "production or gathering"; (2) Assuming that the Act confers jurisdiction over the "production or gathering" activities of a "natural gas company" the issue then is the legal and practical sufficiency of the procedure of including the production and gathering properties and facilities of Petitioner as an in-

herent part of the rate base, that is, the impropriety of applying the public utility theory of rate-making to the production and gathering phase of the natural gas industry; (3) The impropriety of the "cost" method of evaluation applied by the Commission to natural gas production, reserves and leaseholds.

First—The legal interpretation of the language of the Act. The Act does not vest the Commission with unlimited jurisdiction over the natural gas industry. Limitations are specifically set forth. In the declaration of the policy of the Congress appearing in the first paragraph of the Act the Congressional objection clearly is revealed as protection of the public in the *ultimate distribution* of natural gas. In Section 1 (b) of the Act Congress prescribed the jurisdiction of the Commission. This is a precise definition plainly specifying certain areas wherein jurisdiction under the Act does not reach. One such excluded area is "production or gathering" of natural gas. This exemption of "production or gathering" is not a partial exemption. There is no limiting word or phrase appended to this exemption. It is all inclusive. Nowhere in the Act, notwithstanding contentions of the Commission and intimations of some court decisions to the contrary, is there to be found a Congressional attempt to differentiate between "direct" regulation and "indirect" regulation of "production or gathering"—prohibiting "direct" regulation but authorizing "indirect" regulation. Yet in the decision below the Court of Appeals has approved the economic regulation of "production and gathering", as if, economic regulation (1) is not tantamount to total regulation (2) is authorized by language found in the Act.

The Court of Appeals below dismissed this issue by erroneously concluding that it "has already been squarely met and conclusively decided." The pertinent decisions of this Court certainly do not "squarely" meet this issue, with a clear majority in a case where the issue is plainly put. And if the issue is "conclusively" decided by such

decisions it is by accident and not design. If there ever has been a majority of this Court in harmony on this issue as concluded by the court below, it is not recorded in the decisions of this Court. Such a conclusion can find support only through an anomolous, freakish enmeshing and overlapping of opinions—majority, concurring and dissenting—to be found in the pertinent decisions of this Court. A brief analysis reveals the result. In *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, the majority consisted of five Justices of this Court including the late Chief Justice Stone. But in that case the issue here under discussion was not raised. And subsequently the late Chief Justice very clearly pronounced his stand on this issue in his forceful dissent in the related cases of *Colorado Interstate Gas Company* v. *Federal Power Commission* and *Canadian River Gas Company* v. *Federal Power Commission*, 324 U. S. 581. This dissent shows that had the issue been raised in the Hope Case, as is technically required by Section 19 of the Natural Gas Act, the late Chief Justice would not have been with the majority on this issue, leaving this case as *not* an authoritative citation. Also, later we find in the Colorado (Canadian) Cases, *supra*, a four-one-four decision, that Mr. Justice Jackson, concurring, expressly reiterated adherence to his earlier strong dissent in the Hope Case, *supra*, but accepted the Hope decision as a binding authoritative decision of this Court. Its defect as an authoritative decision, *on the instant issue*, has been pointed out.

Under these circumstances can it justifiably be said that the issue here "has already been squarely met and conclusively decided."

In conclusion and with utmost deference it is submitted that the pertinent decision of this Court leave this issue clouded with uncertainty. As a result much time and effort is being wasted by the oil and gas industries in seeking judicial finality. In the absence of a conclusive decision by this Court the Commission, with the sanction of the lower courts, is free to continue its practiced evasions of

the law with extremely adverse repercussions throughout the oil industry as well as the gas industry. A conclusive decision by this Court on this issue even if adverse to the position here advocated, would be, in its finality, a salutary step in removing the uncertainty of a situation that has been developing for eight years, a situation that demands attention and must be removed.

SECOND—The impropriety of applying the public utility theory of rate-making to the natural gas industry. Mr. Justice Jackson's dissenting opinion in the Hope case, *supra,* and concurring opinion in the Colorado (Canadian) Cases, *supra,* so ably and comprehensively cover this matter that, other than cite those opinions, would be to belabor the issue unnecessarily.

THIRD—The impropriety of applying the "cost" theory rather than "value" theory of evaluating current gas production, reserves and leaseholds for inclusion in the rate base. The process applied by the Commission allows the producer or gatherer of gas an interest return on the depreciated historical "cost", so-called, of reserves, producing properties and gathering facilities.

The IPAA is not *immediately* concerned with the Commission's action in this particular proceeding because the hurt is confined temporarily to the one party, the Petitioner. But the consequences of the hurt are not confined. And, therefore, the IPAA becomes extremely concerned with the application of such procedure because of the inevitable drastic industry-wide consequences that are sure to follow.

This practice of the Commission has the amazing effect of according a zero value to large holdings obviously extremely valuable and other instances of according values manifestly inappropriate. Such practice artificially depresses the price of gas throughout the industry, and artificially deters exploratory and development activity. Under this theory the price varies as does the source. Stability within the industry will be unknown. This depressing effect upon price and the entire economics of the industry ines-

capably will permeate the entire oil industry as well as the gas industry. Here, the common denominator for these industries artificially is fixed by fiat and it follows that the economics of these industries will seek this artificial level of its common denominator. The oil and gas industries cannot continue as free enterprise if such unsound regulation of a portion thereof is permitted—which in the end will control the whole.

The "cost" theory as applied by the Commission is in nonconformance with the very nature of the gas industry. Any exploratory or development venture in the gas industry necessarily requires a large margin of risk investment. Such a venture usually involves thousands of acres of land with the understanding that return, if any, on the *entire* investment probably will be realized from only a few of the total acres of land involved. Yet here the Commission ignores these facts and applies a theory that has evolved directly from regulation of public utility activities, in total disregard of the inherent hazards involved in the adventures attendant the development of natural gas reserves—to be contra-distinguishable from the staid, insured, and otherwise protected ventures in public utility activities. It is inconceivable. No industry is less amenable to this theory than the natural gas industry. This practice of the Commission, now sanctioned by the Court below, is inapplicable to the gas industry and ends in irrational and arbitrary results.

The Commission and Court of Appeals below have assumed that this question has been decided by the decisions of this Court. This is without foundation. A majority of this Court has not decided *this issue*. It is submitted, therefore, that the erroneous assumptions of the Court of Appeals below, and the uncertainty and absurd results consequential of the Commission's treatment of this issue warrants review by this Court.

II. Exercise of Authority Over the Cities Service Oil Company.

The Cities Service Oil Company (hereinafter referred to as Oil Company) is a separate corporate entity from the Petitioner, although an affiliate thereof. Like many individuals and other corporate entities in the oil and gas industries, the Oil Company is a processor of natural gas, operating among other activities natural gasoline extraction plants. The Commission segregated these plants from the Oil Company's other properties, ignored the separate corporate entity of the two companies, treated such plants as if they belonged to Petitioner and fixed a return of 6½% on such plants, which plants clearly are not within the jurisdiction of the Commission. This Oil Company is a stranger party to this proceeding and should be treated as such. The Court of Appeals below held that the Commission's exercised authority over the Oil Company was necessary to preclude the "siphoning" off of unjustified profits of the Petitioner. This is an untenable and manifestly erroneous reason. The Court in effect says that the possibility of "siphoning" of profits justifies the Commission in exercising its authority—that such possibility automatically extends the jurisdiction of the Act. Since when have fears and hallucinations of courts prescribed jurisdiction rather than the plain language of Congress recited in the law? This reasoning of the Court of Appeals below would subject all persons, affiliates as well as others, having business dealings with Petitioner, to the authority of the Commission. If Petitioner is determined to circumvent the law it could devise a "siphoning" arrangement with a non-affiliate or independent as readily as with its affiliate. It is conceded that the Commission has the authority and duty to investigate the transactions between Petitioner and others, including affiliates, to assure that such transactions are at arm's length and that the public consumer is not the victim of a "siphoning" arrangement, but this is the limit of the Commission's authority over these matters.

The Court below sustained this action of the Commission on the additional erroneous conclusion that such processing of the natural gas is "essential" to the activities of a "natural gas company". The fallacy here is obvious. If such processing is "essential" then how was it transported 250 miles before being so processed. (R. III, 1125.) Webster's unabridged dictionary in defining the word "essential" uses these descriptions: the essence of something; indispensable; necessary. Can it be said that such processing is the *essence* of transportation or is *indispensable* to transportation or is *necessary* to transportation. The function of transportation as involved here means transference, transmission, or to carry or convey from one place to another. And transportation is the sole physical function, which falls within the jurisdiction of the Act as the following language in Sec. 1 (b), the jurisdictional paragraph, clearly shows:

> this act shall apply to the transportation of natural gas in interstate commerce * * * and to natural gas companies engaged in such transportation * * *

Does such processing act as an impelling force in moving the natural gas, or contribute in any way in carrying or conveying it from one place to another. The activity of natural gasoline extraction is no part of the activity of transportation within any stretch of the meaning or function of these two activities. The activity of extraction is, in fact, an element of the activity of production. Natural gas which is produced in conjunction with petroleum, in its natural reservoir is in a unified solution with the petroleum. In the process of *production* this unified solution escapes to the surface and upon reaching atmospheric pressure certain of the components of this solution drop out as liquid petroleum. Certain of the remaining components of this original solution likewise are reducible to liquified petroleum products upon subjection to the *extraction process* involved here—a process of *producing* petroleum products. If such processing is "essential" to "natural gas com-

pany'' activities under the Act, then logically it can be argued (1) gathering is essential (2) production is essential (3) drilling is essential (4) prospecting is essential, and on to palpable asininity. Great and irreparable injury to an important segment of American industry will result if this Court stands by and permits such flaunting disregard of the intent and purpose and scope of the applicable law.

It is respectfully urged that this Court take cognizance of the practical results of the decision below in sanctioning the Commission to persue its capricious course to an even more farfetched extreme.

III. Summary of Argument.

The decision of the Court of Appeals below, on the two questions argued herein, even though erroneous, at least leaves some limitations upon the authority of the Commission when the effects of the decision with respect to each of said issues is considered separately from the other. But the decision of the two issues, considered conjunctively, removes all jurisdictional limitations from the authority of the Commission with respect to ''production or gathering.'' For example—the decision approving the exercise of authority over the production and gathering properties of Petitioner which is otherwise a ''natural gas company,'' presumably does not approve the exercise of such authority over a producer or gatherer who is *not* otherwise a ''natural gas company'' thereby preserving at least some limitation upon the reach of jurisdiction of the Commission; however, the decision in approving exercise of authority over the Oil Company extraction process, in effect, says that any person engaged in any activity *essential* to the transportation and sale of natural gas who has any dealings whatever with a ''natural gas company'' also is subject to the authority of the Commission, and, as above pointed out, logically the activities of gathering, producing, drilling, prospecting, etc., are even more *essential* to the transportation and sale of natural gas than an extraction plant;

therefore, the effect of the decision of the Court of Appeals below on these two issues, taken conjunctively, is that a producer or gatherer or driller of a well (even though not otherwise a "natural gas company" and presumably exempted from the Act) also is subject to the regulation by the Commission if the gas from his well eventually comes into the possession of a "natural gas company". Thereby, the clear unequivocal exemption of "production or gathering" is rendered entirely meaningless.

In conclusion it is submitted that the decision below on these two issues, taken conjunctively, presents a novel and new issue to this Court, an issue which heretofore has not been raised or decided in a decision of this Court.

CONCLUSION.

The Independent Petroleum Association of America suggests that if the issues were resolved as advocated herein the problem presented to the Commission would be a relatively simple one. Far more simple and economically sound than the procedure now followed. In the case of an integrated company such as Petitioner, the allowance as an operating expense of the going field price for gas at the point of its entrance into the interstate transmission system, and the exclusion of production and gathering properties from the "rate base", would protect every interest of the company, the Commission and the public. With respect to the Commission's treatment of the Oil Company's extraction plants the Commission should review the dealings between the Petitioner and said company to assure that the transactions are at arm's length—and nothing more.

The practices complained of in this brief inescapably impinge on the local situation throughout the oil industry as well as the gas industry by its direct and substantial effects on field prices and upon conservation practices. The issues presented concern not only the statutory limits of the Commission's powers, but reach the basic economy

of the entire oil and natural gas industries.

It, respectfully, is submitted that the present uncertainty and confusion in the law demands the attention of this Court and, therefore, it is urged that the petition for a writ of certiorari be granted.

Respectfully submitted,

RUSSELL B. BROWN,
General Counsel,
L. DAN JONES,
Attorney,
Independent Petroleum Association of America

Dated: At Washington, D. C.
December 7, 1946

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FEDERAL POWER COMMISSION; PUBL
OF THE STATE OF MISSOURI; THE
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AND CORPORATION COMMISSIO
OKLAHOMA,

BRIEF OF AMERICAN PETRO
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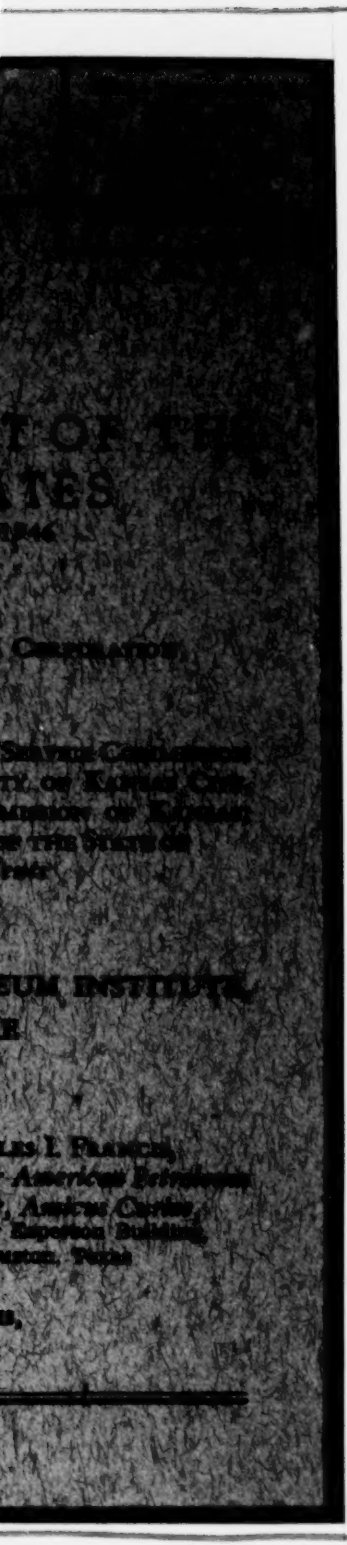

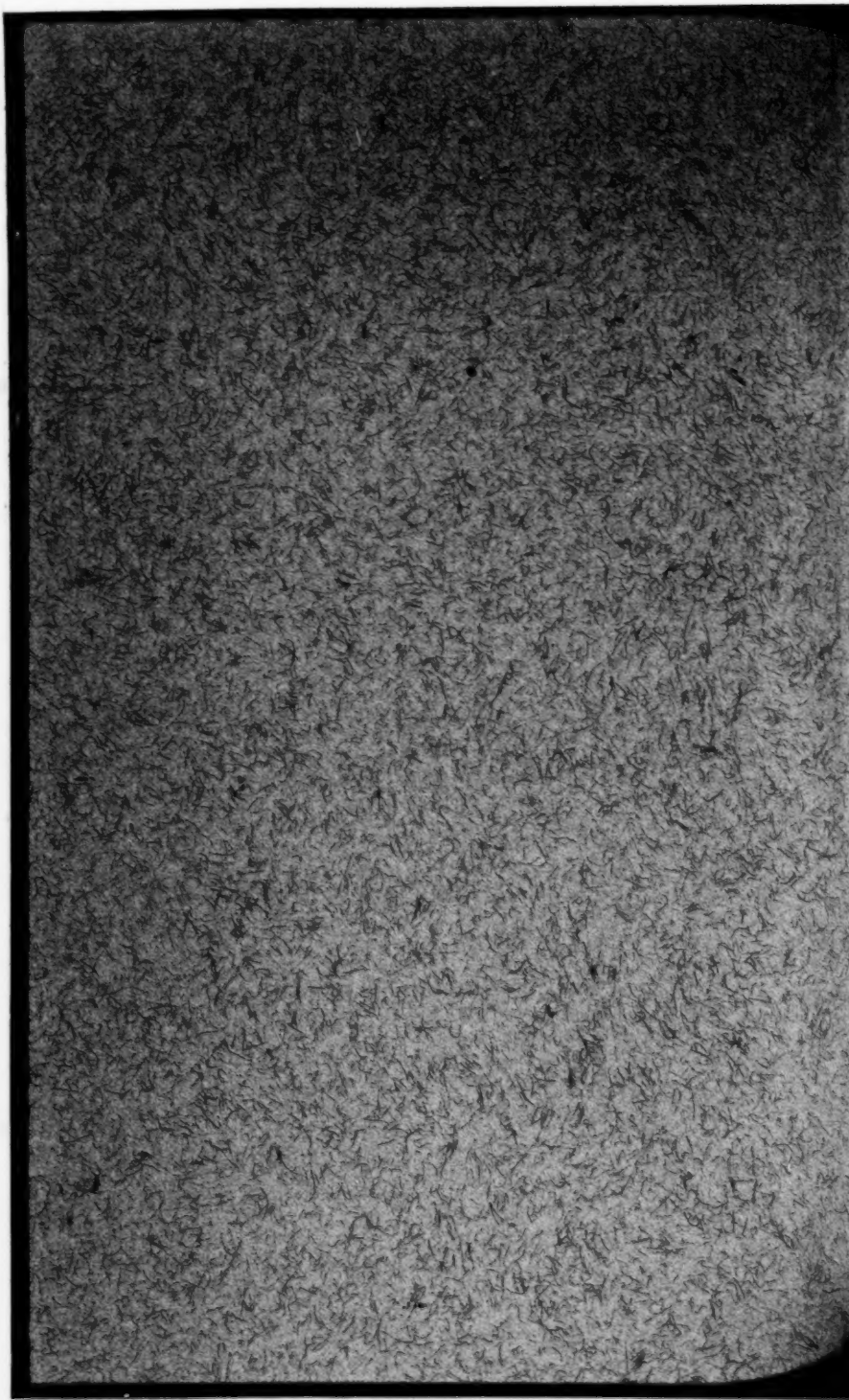

INDEX

AUTHORITIES CITED

No. 556

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

CITIES SERVICE GAS COMPANY, A CORPORATION,
Petitioner,

vs.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; THE CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; AND CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, *Respondents*

MOTION TO FILE BRIEF, AGREEMENT OF PARTIES AND CERTIFICATE OF SERVICE

To the Honorable Supreme Court of the United States:

The American Petroleum Institute requests permission to file the attached amicus curiae brief in said above styled and numbered cause, hereby certifying that permission of all parties to said cause (except the City of Kansas City, Missouri) has been secured, and that copies of this brief have been mailed, properly addressed, with first-class postage prepaid, to each of the following:

Mr. Leon M. Fuquay,
Secretary,
Federal Power Commission,
Washington, D. C.

Hon. George T. Washington,
Acting Solicitor General of
the United States,
Department of Justice,
Washington, D. C.

General Counsel
Corporation Commission of
State of Oklahoma,
Capitol Building,
Oklahoma City, Oklahoma

General Counsel
Public Service Commission of
Missouri,
Capitol Building,
Jefferson City, Missouri

Mr. Jerome M. Joffee,
Special Utilities and Legislative Counsel, City of Kansas City,
Municipal Building,
Kansas City, Missouri

General Counsel
State Corporation Commission of Kansas,
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The City of Kansas City, Missouri, was not an original party to the case but intervened when the case was pending in the United States Circuit Court of Appeals. The Acting Solicitor General of the United States, representing the real party in interest, the Federal Power Commission, has executed a consent agreement along with all other named parties.

DATED at Houston, Texas, this_____day of December, 1946.

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BRIEF OF AMERICAN PETROLEUM INSTITUTE, AMICUS CURIAE

In Support of Petition for Rehearing on Denial of Petition for Writ of Certiorari

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This brief is presented by the American Petroleum Institute, a corporate organization, representing generally and extensively all branches of the oil and gas industry. Its membership, consisting of about 5,000 members of the oil and gas industry, reaches into every state of the Union, and includes producers of crude petroleum and natural gas, refiners of

petroleum and its products, transporters of crude petroleum or its products, or natural gas through pipelines, owners of oil and gas royalties, land owners and many others engaged in some branch or branches of the oil or gas business. Because of the very close interrelation in the discovery, production, transportation and sale of oil and natural gas, virtually all members of this Association and all others similarly engaged in the oil and gas industry, are affected by and concerned in the legal problems in connection with the "production and gathering" of natural gas and other related problems herein referred to.

By reason of its very real, immediate and extensive interest in such problems, the Institute took an active part in the proceedings initiated by the Federal Power Commission, entitled: Natural Gas Investigation, Docket G-580, to investigate "the interstate aspects" of the natural gas industry. In that proceeding many hearings were held, both in gas-producing and gas-consuming areas of the United States, during the year 1946, where the various questions here under discussion were extensively presented.

Since the production of oil and the production of gas are so interrelated, the failure of the courts, and particularly of this Court, to clarify, settle and dispose of the various questions involved in this case, inevitably now does and will continue substantially to affect and actually to curtail much exploration and development and the consequent sales and utilization of natural gas. This is true whether natural gas is produced locally by a "natural gas company," under the Gas Act, or by other producers of gas or the many producers of petroleum also producing natural gas. Producers other than producing interstate pipelines have not been regulated by the Federal Power Commission as yet, but the conviction is widespread throughout the country that the Commission,

in its desire to enlarge its own powers, will bring them within the scope of its regulations. Such result certainly seems highly probable in view of the present trends and developments in Commission and judicial action, procedure and decision. The specific and controlling provisions of the Natural Gas Act have been overlooked and forgotten in this program of expanding Federal regulation.

The broad questions presented in this case, in which this Association is thus vitally concerned, arise out of a rate reduction order of the Federal Power Commission; the judgment of the Circuit Court of Appeals for the Tenth Circuit, affirming that Commission order on April 30, 1946 (155 Fed. (2d) 694); and the order of this Court, refusing to grant certiorari herein.

The fundamental issues as to which the Institute has such direct, specific and immediate interest and concern are:

I.

The inclusion of the production and gathering properties, including natural gas reserves, of the petitioner in this case and, therefore, of every producing "natural gas company," in the Commission-determined utility rate base. This includes not only that portion (undefined) of those properties devoted to the regulated business and operations, but the remaining portion thereof devoted to its non-regulated business and operations as well.

II.

The exclusion, *as a matter of law*, by the Commission trial examiner, approved by the Commission and by the Court of Appeals, of all evidence of "value" of such production properties, including natural gas reserves, and the adoption of Commission "cost," *as a matter of law*, as the sole criterion for the determination of the utility regulated rate base.

III.

The Commission appropriated all earnings of an affiliated company which is separate and distinct, both in operation and corporate entity from the petitioner herein, arising out of the extraction of natural gas gasoline from certain of the natural gas produced and sold by petitioner, under contract between the petitioner and such affiliate. The earnings so appropriated were designated by the Commission, with the approval of the Court of Appeals, as "excess earnings." The amount thereof was determined by imposing upon the Commission-segregated natural gas gasoline extraction plants and operations of the affiliate, in a separate rate case to which the affiliate was not a party, the Commission "cost" rate base of such properties. The Commission procedure in that behalf was identical with the procedure followed by it in this rate case of the petitioner as a regulated "natural gas company" under the Act. The excess of such earnings of the affiliate from such operations, also as fixed by the Commission, over and above 6½% on the Commission-imposed "cost" rate base, was designated as "excess earnings." The affiliate is not a "natural gas company" under the Act, and is not subject otherwise to the authority of the Federal Power Commission. Such so-called "excess earnings" were credited to the expense account of the petitioner, thus reducing its actual expenses and the Commission "cost of service allocation" base by such credit and increasing the petitioner's purported net earnings by the same amount.

IV.

The evident disposition of the courts to endow Commission action with the attribute of finality, notwithstanding the governing and established principles of law which Con-

gress, in Section 19(b) of the NATURAL GAS ACT, declared should be applicable.

The remaining questions in this case, as disposed of by Commission and Court of Appeals, relating to "existing depreciation," "Federal income taxes," "allocation" and the right to actual though limited judicial review before a Court of Appeals and before this Court, also are of direct concern to all enterprises now regulated by the Commission and to all others which the Commission hereafter may seek to subject to its regulation.

However, the brief discussion herein, supplementing the presentation thereof by petitioner in its petition for certiorari and supporting briefs, will be limited to the four broad fundamental issues above enumerated.

Discussion

I.

Asserted Jurisdiction of the Commission Over "the Production or Gathering of Natural Gas"

Section 1(a) and (b) of the GAS ACT delegate to the Commission regulatory authority over "transportation of natural gas in interstate commerce" and over "the sale in interstate commerce of natural gas for resale * * *," and over no other operations, activities or properties. Affirmatively and expressly Section 1(b) of the ACT provides: "*The provisions of this Act * * * shall not apply* to any other transportation or sale * * * or *to the production or gathering of natural gas.*" This "shall not" limitation expressly relates to the entire Act.

Nevertheless the Commission has exercised *regulatory authority* over all production and gathering properties, opera-

tions and business, including natural gas leaseholds and reserves of the petitioner herein. This action of the Commission the Court of Appeals, in this case, has declared to be proper and lawful under the Gas Act (R. V. 3, pp. 1328-1329), on the asserted authority of the decision of this Court in CANADIAN RIVER GAS CO. v. FEDERAL POWER COM., 324 U.S. 581, 65 S. Ct. 829.

That case, in which the Commission had included "the production and gathering facilities" and as a part thereof all natural gas lands, leaseholds and reserves of Canadian in the so-called utility rate base, was affirmed in this Court by a five to four decision. Of the five justices who participated in the affirmance, four speaking through MR. JUSTICE DOUGLAS declared that certain other sections of the Act required disregard of the clear and direct *jurisdictional* limitation and mandate of Section 1(b) of the Act. "We must read Section 1(b) in the context of the whole Act," said Mr. JUSTICE DOUGLAS. With this philosophy of statutory construction, MR. JUSTICE JACKSON, whose vote was necessary for affirmance of the case, did not agree. He took the position that "If the Commission had imposed any direct regulation upon that activity, I would join in holding it to have exceeded its jurisdiction." Such also was his view respecting the analogous "shall not" provisions of Section 201(b) of the Power Act (CONNECTICUT L. & P. CO. v. FEDERAL POWER COMM., 324 U.S. 515, 65 S. Ct. 749). Thus in the CANADIAN case there was no authoritative determination by a majority of the Court supporting the exercise by the Commission of regulatory jurisdiction over production and gathering (UNITED STATES v. PINK, 315 U.S. 203, 62 S. Ct. 552).

In the CANADIAN case it was also the view of MR. JUSTICE JACKSON that the inclusion of the production and gathering properties and operations in the regulated rate base was the investigation of the "fiscal aspects" of such business and con-

stituted the taking of "evidence as to conditions and events quite beyond its regulatory jurisdiction where they are thought to affect the cost of that whose price it is directed to determine." On this ground he joined in the affirmance upon the question of jurisdiction. With this conception none of the other eight members of this Court agreed. MR. JUSTICE DOUGLAS and his three concurring associates and the late MR. CHIEF JUSTICE STONE and his three concurring associates, all concurred in the conclusion that the inclusion of such properties in the utility rate base, *in fact*, was the exercise of direct regulatory jurisdiction over production and gathering. The only disagreement between these two groups on the jurisdictional issue was the question of legality or illegality of the Commission action.

Furthermore, the identical contention made by MR. JUSTICE JACKSON in the CANADIAN case was laid at rest by CHIEF JUSTICE WHITE, speaking for the entire Court, in SOUTHERN PACIFIC CO. v. INTERSTATE COMMERCE COMM., 219 U.S. 433, 31 S. Ct. 288. It was there held that the character of the power which the Commission actually exercised was determined by the nature and substance of the order under review. *Here, precisely the same regulatory control, procedure and order were applied to the production and gathering properties and business as to the admittedly regulable properties and business. Regulation is regulation by whatever name it may be designated.*

On such a state of uncertainty as to the meaning and effect of Section 1(b) of the NATURAL GAS ACT, which on its face is entirely plain and definite, the broad and public necessity for a clear and unequivocal determination by this Court of that jurisdictional question, which is presented directly in this case, is abundantly apparent.

II.

The exclusion, as a matter of law, by the Commission, with the approval of the Court of Appeals, of all evidence of "value" of natural gas reserves in its determination of the controlling rate base, which included such properties at zero or at merely nominal amounts.

This question is not a corollary of the issue of Commission jurisdiction above considered. It is asserted by the Commission, its staff and its counsel that the Commission is *required, as a matter of law*, by Section 6(a) of the NATURAL GAS ACT, to use "cost" and only "cost" in its determination of rate base and rates. "Value," it seems, may be considered only in a case where "the exigencies of the particular situation require such a determination," which exigency, according to the record in this case, cannot arise if "the actual legitimate cost of these leases can be determined from the books" (R. V. 1, pp. 31-32, 152-153, 161, 163, 164, 165-166, 183-184, 385-387). The viewpoint of the Commission in laying down its rigid rule outlawing "value" is stated in its opinion as follows: "Our views as to why such evidence should be excluded have been stated in earlier opinions, and need not be amplified here" (R. V. 1, p. 31).

This Court repeatedly has declared to the contrary that "the Commission was not bound by the use of any single formula in determining rates" (FEDERAL POWER COMM. v. NATURAL GAS PIPELINE COMPANY, 315 U.S. 575, 62 S. Ct. 736; CANADIAN RIVER GAS CO. v. FEDERAL POWER COMM., 324 U.S. 581, 65 S. Ct. 829).

Thus, the Commission's total exclusion of all evidence of "value" of gas reserves rested upon a misconception of the law. Not having followed "the correct rule of law" (CON-

NECTICUT L. & P. Co. v. FEDERAL POWER COMM., supra), its order must be set aside.

The question of "value" of natural gas reserves presented in this record has not been resolved and determined in any decision of this Court. In the CANADIAN case MR. JUSTICE DOUGLAS, speaking for himself and his three concurring associates, declined to consider that question in that case on the ground that it "could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case." Nor was the issue of "value" of gas reserves involved in the case of FEDERAL POWER COMMISSION v. HOPE NATURAL GAS COMPANY, 320 U.S. 591, 64 S. Ct. 291. This was pointed out by MR. JUSTICE JACKSON in the CANADIAN case (324 U.S. at 645, 65 S. Ct. 308), and by JUDGE PHILLIPS in his dissenting opinion in this case (R. V. 3, p. 1347).

Here, then, is a fundamental and far-reaching issue of wide and general importance, to-wit: Whether, assuming Commission regulatory jurisdiction over the production and gathering properties and operations of a "natural gas company," the Commission lawfully may exclude all evidence of "value" of natural gas reserves in the rate case hearing preliminary to determination of rate base. It would seem clear from what this Court has declared on the subject that it may not do so, and yet, in this case where the Commission did that precise thing, this Court, no doubt inadvertently, has denied writ of certiorari to correct such far-reaching and serious error of law indulged by both Commission and Court of Appeals.

This Court of course recognizes the fact that the application of the fixed "cost" formula of the Commission to natural gas reserves also substantially will affect and operate to unsettle and confuse the market price of natural gas as a commodity. This is a matter of impressive and wide im-

portance. The confusion results from the fact that most producer-pipelines presently are obliged to *give away* much of their annual production because there is no return allowed on reserves incorporated into the utility's rate base at zero dollars and virtually no return on those reserves included in such rate base at nominal "cost." The result of the Commission concept is that the price of natural gas as a commodity depends upon who produces that gas. There is neither economics nor sense in such a dual price standard, and it is one which the legislative history of the Natural Gas Act shows Congress did not intend, but did intend should not result.

III.

The expropriation by the Commission, acquiesced in by the Court of Appeals, of the Commission-determined so-called "excess profits" realized from the extraction of natural gas gasoline from a portion of petitioner's produced and purchased gas, by an affiliate company under contract with petitioner.

The procedure followed by the Commission in this matter is sufficiently detailed for present purposes in the statement of Point III, supra.

In treating the separate and disassociated extraction plants, properties and operations of petitioner's affiliate "as if they belonged to petitioner" (R. V. 2, pp. 792, 802) and thereupon subjecting them to the same direct and specific rate-regulatory processes utilized in the regulation of petitioner's regulable rates, the Commission embarked on nothing other or less than "regulation." The segregation of such extraction plants and business from the other properties and operations of the affiliate, the fixation of a depreciated "cost" rate

base thereof, the allowance or disallowance of expenses chargeable against gross revenue, the determination of total net earnings, the fixation of an allowable rate of return, and the disallowance of all profits in excess of the allowed rate of return ($380,000 a year) (R. V. 1, pp. 53-54) are the devices, implements and end results of regulation. They are direct regulation of the property and business of the affiliate, clearly not subject to regulation by the Commission. This fact cannot be altered or dissipated by words or by straining logic to absurd extremes (SOUTHERN PACIFIC CO. v. INTERSTATE COMMERCE COMM., 219 U.S. 433, 31 S. Ct. 288). Congress did not grant the Commission any such jurisdiction.

The Commission made no effort whatever "to make any adjustment in the price" paid by the affiliate to petitioner for the processed gas (R. V. 2, p. 802). The principle of law that commission and court alike may inquire into the reasonableness of contracts between affiliates and adjust the contract to conform to "arm's length dealings" was disregarded entirely throughout this case.

The contention is made by Commission counsel (COMM. BR., p. 17) as well as by the Court of Appeals (R. V. 3, p. 1336), to support the Commission exercise of this direct rate-regulatory control over the gasoline extraction plants and operations of the affiliate, that otherwise a regulated gas utility would be enabled "to syphon off profits to nonregulated affiliates." This argument does not stand up. Heretofore, in many cases and as a matter of established procedure, commissions and courts alike, *without attempting to exercise regulatory control over the non-regulated affiliate,* have made inquiry into and required that the contractual relations between affiliates be reasonable and equivalent to "arm's length dealings." Such is the law (SMITH v. ILLINOIS BELL TEL. CO., 282 U.S. 133, 51 S. Ct. 65; UNITED FUEL GAS CO. v. RAILROAD COMM., 278 U.S. 300, 49 S. Ct. 150;

dissenting opinion, CHIEF JUSTICE STONE, in CANADIAN RIVER GAS COMPANY case, 324 U.S. 581, 65 S. Ct. 829).

Neither the Natural Gas Act nor any established principle of law contemplates or permits the Commission procedures here under consideration. Here is action by a federal administrative agency in excess of its authority under a federal statute which a federal circuit court of appeals refuses to redress. Such a "special and important" situation should move this Court now to take jurisdiction in the exercise of its "sound judicial discretion."

IV.

Denial of Judicial Review Under Section 19 (b) of the Natural Gas Act

This amicus curiae is convinced, if review on certiorari be not granted in this case, wherein the "special and important reasons" therefor and the considerations of "gravity and general importance" are so numerous and clear, that the statutory review under the Natural Gas Act becomes a virtual nullity.

There are here present: principles of law, statutory interpretations and serious issues, all unsettled, undetermined and in confusion; abuse and overreaching of its statutory authority by the Commission; refusal of the Court of Appeals on the plea of impotency to perform its mandated functions and duties as the court of review; disregard by Commission and Court of Appeals alike of established and prevailing principles and rules of law; and a Commission opinion without adequate findings and containing findings without record support. Each of such principles and issues is of special importance and general gravity and concern.

WHEREFORE, respectfully this Court is requested and urged to grant writ of certiorari herein.

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v.

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On Petition for Rehearing on the Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF MID-CONTINENT OIL & GAS ASSOCIATION AS AMICUS CURIAE ON PETITION FOR REHEARING ON RULING DENYING WRIT OF CERTIORARI.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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On Petition for Rehearing on the Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

The Mid-Continent Oil & Gas Association, by its Attorneys, moves this Honorable Court for leave to file, as amicus curiae, the accompanying brief on the petition for rehearing filed herein. The written consent of all the parties to this proceeding, with the single exception of the City of Kansas City, Missouri, which is not an original party hereto, have been obtained.

Respectfully submitted,

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On Petition for Rehearing on the Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

BRIEF OF MID-CONTINENT OIL & GAS ASSOCIATION AS AMICUS CURIAE ON PETITION FOR REHEARING ON RULING DENYING WRIT OF CERTIORARI.

Mid-Continent Oil & Gas Association, as amicus curiae only, submits its brief to request this Court to grant to Cities Service Gas Company, petitioner for rehearing herein, a rehearing on the question of allowance of a writ of certiorari. Its reasons for so doing are clearly reflected by the points of law and fact actually involved in the instant case which portray the very substantial and adverse effect the failure to clarify the points involved by an au-

thoritative decision of this Court will have on this association and those it represents.

Mid-Continent Oil & Gas Association, with general headquarters at Tulsa, Oklahoma, is an oil and gas trade association with approximately 3,000 members, representing and serving all branches of the petroleum industry and related businesses, and in particular, a majority of the oil and gas producers in the States of Kansas, Oklahoma, Texas, New Mexico, Arkansas, Louisiana, Mississippi, and Alabama, in which area three-fourths of the nation's natural gas and over two-thirds of the nation's crude petroleum is produced. This association is not concerned with this rate case as such but is vitally and deeply interested in the questions necessarily arising out of and precipitated by the decision of the Tenth Circuit Court of Appeals, sought to be reviewed in this Court.

The concern of this association and the producers it represents is to secure a clarification of the decisions bearing upon the question of whether the first sale of a producer of gas to an interstate pipeline company subjects such producer to regulation by the Federal Power Commission and/or causes such producer to become a natural gas company under the Natural Gas Act. Since very often gas is produced as an inseparable part of the production of oil, the interest of this association is also for the determination of whether such first sale of gas produced with oil would subject the producer to such regulation by the Federal Power Commission and cause it to become a natural gas company.

In this case the producing and gathering facilities of the petitioner were placed in the rate base, and it was permitted to earn only a 6½ percent return on the depreciated "cost" of these facilities, which had the effect of requiring the petitioner practically to give away the gas it produced from leases covering some 68,000 acres of land in the Texas Panhandle. Thus, the Commission effectively determined what the petitioner could realize from its producing and gathering operations and regulated its production and gathering activities, despite the express provision to the contrary in

the Natural Gas Act. While this case does not involve the producer or gatherer who sells his gas in the field where produced to a natural gas company, and a denial of certiorari in this case would not necessarily authorize the Commission to assume that it could take jurisdiction over producers and gatherers who make field sales and deliveries to natural gas companies, nevertheless a decision by this Court holding that the Commission can have no jurisdiction over the producing and gathering activities of the petitioner would effectively stop the known efforts of the Commission to exercise jurisdiction over producers and gatherers who make field sales to natural gas companies and would save producers and gatherers much anxiety and unnecessary future litigation.

The Federal Power Commission, with approval of the Circuit Court, in this case has asserted and exercised jurisdiction over the production and gathering of natural gas notwithstanding the provisions of Section 1 (b) of the Natural Gas Act. Upon the question of the power or right of the Federal Power Commission to assert and exercise such jurisdiction, a majority of this Court has never affirmed the right. The Circuit Court apparently labored under the impression that this Court, in *Canadian River Gas Co.* v. *Federal Power Comm.*, 324 U. S. 581, 89 L. Ed. 1206, squarely and conclusively decided the jurisdiction of the Federal Power Commission over "production or gathering of natural gas," as it spoke of the decision as "the prevailing view." A careful examination and appraisal of the legal force and effect of the decision in the *Canadian River* case reflects there are three separate and distinct views expressed in the opinion, but no majority of this Court concurred that the Federal Power Commission had regulatory authority over the producing and gathering of natural gas. Justices Douglas, Black, Murphy and Rutledge, constituting a minority of the Court, announced the view erroneously described by the Court of Appeals as the "prevailing view." Justice Jackson announced a different view, and said:

> "It is true that the Act excludes 'production or gathering of natural gas' from jurisdiction of the Commission. If the Commission had imposed any direct regulation upon that activity, I would join in holding it to have exceeded its jurisdiction. But the orders in question have no immediate 'impact' upon production or gathering of gas."

Justices Roberts, Reed and Frankfurter announced still a different view.

In *U. S.* v. *Pink*, 315 U. S. 203, 86 L. Ed. 797, the 3rd syllabus reads:

> "An affirmance by an equally divided court, while conclusive on the parties, is not an authoritative precedent for other cases."

On page 810 of the Law Edition the Court said:

> "* * * nor was our affirmance of the judgment in that case by an equally divided court an authoritative precedent. While it was conclusive and binding upon the parties as respects that controversy, the lack of agreement by a majority of the Court on the principles of law involved prevents it from being an authoritative determination for other cases."

It therefore clearly appears that no authoritative decision confirming the jurisdiction of the Federal Power Commission over the production or gathering of natural gas has been made. Unless an authoritative decision of a majority of this Court be rendered upon this point there will continue to remain serious doubt and confusion as to the question, not only as an academic matter among lawyers but also in the minds and business determinations of thousands of oil and gas producers all over the nation. The fear on the part of the oil and gas industry that any first sale will entail the consequences above set out has been further increased and enlarged by the decisions of the United States Court of Appeals for the District of Columbia (*Peoples Natural Gas Co., et al.* v. *Federal Power Comm.*, 127 F. 2d 153, and *Interstate Natural Gas Co.* v. *Federal Power*

Comm., 156 F. 2d 949, decided by the Circuit Court of the Fifth Circuit, August 3, 1946).

The denial of a review of the Circuit Court's decision in the instant case will add further to the confusion existing in the industry, retard exploration and jeopardize the progress of the industry as a whole.

Those producers of oil and gas whom this association represents do not wish the price of natural gas artificially depressed by any regulation of the Federal Power Commission which allows the producer or gatherer of gas only an interest return on the depreciated so-called historical "cost" of reserves, producing properties and gathering facilities. They feel that price control thus exercised not only tends unjustly to depress the value of all gas in the field, but in most cases results in unjust discrimination among royalty owners and also among producers operating in the same field and acts as a deterrent to further exploration and development.

To hold that the price received by a producer and gatherer of gas sold to an interstate pipeline company may be regulated is to hold that the activity of producing and gathering, notwithstanding the plain language of the statute, is subject to the same regulation as a natural gas company. The jurisdiction to fix price is the power to regulate every activity with respect to the commodity sold. Therefore, to hold that the Commission may regulate the price which may be paid to the producer and gatherer of gas is to completely override the exemption expressly granted by the statute.

Section 1 (b) of the Act reads:

> "The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas

or to the facilities used for such distribution or *to the production or gathering of natural gas.*"

By plain language Congress refused to confer upon the Federal Power Commission the right to regulate the production or the power to regulate the gathering of natural gas. Apparently it did not undertake to regulate the gathering of natural gas because it doubtless recognized that gathering was an incident to production—a purely local activity. Transportation and sale for resale within the meaning of the Act do not include production or gathering. The unambiguous intent of Congress was to exempt "production or gathering of natural gas" from the jurisdiction of the Federal Power Commission, and of necessity the language used clearly excludes production and gathering facilities and the necessary sale of gas by the producer and gatherer. Such a sale is clearly incidental to producing and gathering and, of necessity, is not within the jurisdiction of the Commission.

The vexatious effect upon the oil and gas industry of the fear of regulation by the Federal Power Commission being imposed upon its members who are producers to whom a first sale of gas is necessary to realize for them the fruits of production and gathering is multiplied by the apparent holding of the Federal Power Commission, with the approval of the Circuit Court, that it is required by Section 6 (a) of the Natural Gas Act to use the so-called "cost" formula exclusively where costs can be ascertained. This means that the price of gas depends on who produces it—a condition which inevitably destroys any orderly or stabilized field price for natural gas. In arriving at cost the Commission makes no adjustment for the decimated dollar devalued by joint resolution of Congress and proclamation of the President. Furthermore, no producer would explore or develop for the reward of earnings based upon cost. In the oil and gas business the lease that costs one dollar today might be worth a million dollars tomorrow, and it is that hope of reward which inspires producers to assume the

enormous financial risks involved in the exploration for and production of oil and gas. This Court has repeatedly held (*Natural Gas Pipe Line Co. of America* v. *Federal Power Comm.*, 315 U. S. 575, 86 Law Ed. 1073; *Hope Natural Gas Co.* v. *Federal Power Comm.*, 320 U. S. 591, 88 L. Ed. 333), that the Commission is not required to use any one formula or combination of formulae to arrive at the end results of "fair and reasonable" rates. This Court expressly refused to pass upon the questions in the case of *Canadian River Gas Co.* v. *Federal Power Comm.*, 324 U. S. 581, 89 L. Ed. 1206, of whether a determination of what is real "cost" and of whether, when cost is available, the Commission would be bound to ignore value and adopt this so-called "cost". A determination of the controlling rule of law in this regard is left entirely unsettled and undecided and a clarification of that situation is important to the industry this association represents.

The application of the Commission's so-called policy of restricted earnings for producing and gathering facilities based on the depreciated historical "cost" of such properties results in discouraging exploration and production, loads to gross discrimination as between producers and sellers in the same field and between fields, depresses the price of natural gas, denies natural gas companies subject to the jurisdiction of the Commission a reasonable return on the value of their producing properties, impresses the local activity of gathering and producing with a public utility status, and encourages waste of a valuable natural resource. If the situation be clarified by a decision in this case, the so-called atrocious waste in this industry would be eliminated or drastically reduced. If producers of oil and gas felt that the sale of this flared gas to a pipe line company would not subject them to prohibitively low prices for their product, they would feel justified in incurring the expense necessary to carry the gas from the wells or gasoline plants to the pipe lines and selling it to them for use in homes and industry in place of venting it into the air. The vast scale of these transactions renders the question in this

case of very great importance to the industry we represent, to the states, and to the people of this country.

There seems to be no practical avenue of relief for the producers whom this association represents directly accorded to them other than to assist, as far as possible, in the procurement of an actual judicial review, under Section 19 (b) of the Natural Gas Act, of a case in which the questions hereinbefore discussed are involved.

We therefore believe and are convinced (a) that a full decision on the questions presented in this case may remove the dire dilemma in which oil and gas producers find themselves without fault of their own; (b) that enormous waste of natural resources will continue if the present trend of decisions, caused we believe by a misconception of the decisions of this Court, is not clarified; and (c) that a refusal of this Court to grant a review in this case and decide the issues herein presented will in fact, if not in law, lend validity to the erroneous views of the Federal Power Commission and the Circuit Court of Appeals and contribute further in retarding development and exploration by producers.

The inseparability between production of gas and realization of the fruits thereof on first sale or use was by close and undistinguishable analogy declared in *Brown* v. *Maryland*, 12 Wheat. 419, 6 L. Ed. 678, loc. cit. 685, by Chief Justice Marshall, as follows:

> "There is no difference, in effect, between a power to prohibit the sale of an article and the power to prohibit its introduction into the country. The one would be a necessary consequence of the other. No goods would be imported *if none could be sold.*"

Therefore, it would seem that the law ought to be clarified to show that a producer, by first sale or first use of the gas, did not subject himself to regulation by the Federal Power Commission or become a natural gas company, and that a natural gas company as to production and gathering had a right to the fruits of such production and gather-

ing without regulation by said Commission, if upon full consideration the Court conceives that to be the law. It has well been said by this Court:

> "It is almost as important that the law should be settled permanently, as that it should be settled correctly. Its rules should be fixed deliberately and adhered to firmly, unless clearly erroneous. Vacillation is a serious evil. Misera est servitus ubi jus est vagum aut incertum; Gilman v. City of Philadelphia, 3 Wall. 724, 18 L. Ed. 96, loc. cit. 99."

We agree with this time honored maxim and its method of use by this Court and that it is a legal, practical and colloquial truth that "it is a miserable slavery where the law is vague or uncertain."

Respectfully submitted,

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SUMMARY OF PETITION FOR REHEARING.

SUMMARY OF PETITION FOR REHEARING (CONTINUED).

AUTHORITIES CITED.

AUTHORITIES CITED (CONTINUED).

SUPREME COURT OF THE UNITED STATES

October Term, 1946.

No. 556

CITIES SERVICE GAS COMPANY, a corporation,
PETITIONER,

vs.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; the CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; and CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, RESPONDENTS.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

PETITION OF CITIES SERVICE GAS COMPANY FOR REHEARING OF DENIAL OF WRIT OF CERTIORARI HEREIN.

The judgment of this Court denying petition for writ of certiorari was entered herein on November 12, 1945.

Respectfully, the individual members of this Court are asked, in the exercise of a "sound judicial discretion" upon

the foundation of numerous "special and important reasons"[1] manifestly here present, at this time to give direct and specific judicial consideration to the broad, basic, unsettled and probably or certainly erroneously decided issues presented in this record, to the end that there be the actual statutory judicial review on the merits as contemplated, authorized and commanded by the Congress in the Natural Gas Act.

Judicial review under *Section 19(b)* of the Gas Act, before this Court as well as before a court of appeals, is identical in substance with and in the exact legislative language employed in several of the numerous standard and established statutory judicial reviews of orders of other federal administrative agencies accorded by the Congress *(Pet. for Certiorari, Supporting Br., pp. 42-43).* In no other situation has there been so much judicial discussion of and insistence upon the narrow limits of statutory reviews as in cases arising under the Gas Act. "We do not stop to develop" the background and motivating theories thereof.

For example, notwithstanding the very special and rigid rule laid down by Congress in the Internal Revenue Code, restricting judicial review of the decisions of the Tax Court solely to "a clear-cut mistake of law," this Court has found it proper and indeed necessary in the exercise of a "sound judicial discretion" to grant certiorari in numerous and variant cases. In several instances certiorari was granted after once denying petitions therefor. See decisions cited in Footnote 4, *infra.*

On the other hand, it is striking that up to this time this Court has refused to grant the full statutory review to any natural gas company. In some cases it granted highly restricted reviews[2] which actually operated: largely to defeat the judicial supervision and review contemplated by Con-

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1. See Rule 38, this Court.

2. Colorado Interstate Gas Co. v. Federal Power Comm., 324 U. S. 581, 65 S. Ct. 829; Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 626, 65 S. Ct. 850; Panhandle Eastern Pipe Line Co. v. Federal Power Comm., 324 U. S. 635, 65 S. Ct. 821; Canadian River Gas Co. v. Federal Power Comm., 324 U. S. 581, 65 S. Ct. 829.

gress; to commit fundamental and vital questions virtually to uncontrolled Commission "discretion"; and to leave undetermined important principles and questions of statutory construction.

While a review in this Court on writ of certiorari "is not a matter of right," as it is in the Court of Appeals *(Sec. 19(b)* of the Gas Act), nevertheless the function and duty of this Court is the exercise of a "sound judicial discretion," which requires no extensive definition, elaboration or citation of authority. The very words carry their own impressive credentials. It is a "judicial" judgment, deliberate and considered, consisting of and resulting from inquiry into the sufficiency of the legal and equitable foundations of the "findings," conclusions of law and pronouncements sought to be reviewed, agreeable to the established institutions, usages and principles of law constituting our system of government, and conformable to the facts, to reason, to fairness and to the normal processes of logic.[3]

The "special and important reasons," here present, which are amply sufficient to require the supervision of this Court, include among other things: a decision of a federal question by a circuit court of appeals and by a federal administrative agency "in a way probably in conflict with applicable decisions of this Court"; a decision by a circuit court of appeals and by a federal administrative agency probably in conflict with the governing Act of Congress; a decision by a circuit court of appeals and by a federal administrative agency probably involving erroneous conclusions of law; a decision by a circuit court of appeals refusing "to exercise its authority when it is its duty to do so"; a decision of a court of appeals which probably must be re-

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3. This Court, succinctly and broadly, has stated the governing standard:

> "The term 'discretion' denotes the absence of a hard and fast rule. The Styria, Scopinich, Claimant, v. Morgan, 186 U. S. 1, 9, 22 S. Ct. 731, 46 L.Ed. 1027. When invoked as a guide to judicial action, it means a sound discretion, that is to say, a discretion exercised not arbitrarily or willfully, but with regard to what is right and equitable under the circumstances and the law, and directed by the reason and conscience of the judge to a just result." Langnes v. Green, 282 U. S. 531, 541, 51 S. Ct. 243, 247.

garded "as having repudiated jurisdiction" imposed on that court; and questions "which later must be taken because of conflict" or to clarify confusion and uncertainty or to avoid multiplicty of suits.[4]

The bald fact, that questions of "gravity and general importance," not heretofore authoritatively determined, are here involved cannot be cast aside and rejected in the face of the record and issues presented and on file in this Court.

In this connection, as highly relevant and being a matter of common and general knowledge, the attention of this Court is invited to the pending proceeding before the Federal Power Commission, entitled Re: Natural Gas Investigation, Docket G-580, undertaken, according to the Commission "agenda" released June 27, 1945, to investigate "the interstate aspects of the natural gas industry in which the Commission is concerned." In this proceeding, during the current year 1946, numerous and extensive hearings were held in various cities in both the gas-producing and gas-consuming States. Appearing and participating therein, in addition to groups directly representing all phases of the natural gas industry throughout the country, that is, production, transmission, distribution and consumption, were the oil industry on a nation-wide basis, various States concerned in various phases of the natural gas business from production to consumption, represented by their Governors and regulatory bodies, numerous consumer groups, and many others concerned in one way or another in the matters under consideration. From all sources and from all participants, except the Power Commission, the ultimate and insistent complaint was abuse of its authority and disregard of the statu-

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4. See: Rule 38, this Court; McDonald v. Comm'r. Int. Revenue, 323 U.S. 57, 65 S.Ct. 96; Mahnich v. Southern S.S. Co., 321 U.S. 96, 64 S.Ct. 455; Connecticut L. & P. Co. v. Federal Power Comm., 324 U.S. 515, 65 S.Ct. 749; R. Simpson & Co., Inc., v. Comm'r. Int. Revenue, 321 U.S. 804, 64 S.Ct. 496; Comm'r. Int. Revenue v. Wilcox, ——U.S.——, 66 S.Ct. 546; United States, etc., Assn. v. United States, 325 U.S. 196, 65 S.Ct. 1120; John Kelly Co. v. Comm'r. Int. Revenue, ——U.S.——, 66 S.Ct. 299.

See Pet. for Cert. and Supporting Brief, pp. 3-5, 28-29, 41-46.

See also Meredith v. City of Winter Haven, 320 U.S. 228, 229, 237, 64 S.Ct. 7, 9, 12; Federal Trade Comm. v. American Tobacco Co., 274 U.S. 543, 47 S.Ct. 663.

tory limits of its jurisdiction by the Commission, and the failure of the courts to exercise supervision, restraint, control and correction over the now practically uncontrolled activities of that agency. Therein was abundantly disclosed, as present and immediate, questions of very great "gravity and general concern" on a nation-wide basis and affecting substantially in various ways most producers, transporters, distributers and consumers of natural gas.[5]

The several applications herein for leave to appear and to present briefs *amici curiae* by organizations, with a combined nationwide membership in excess of 15,000 and broadly representative of the gas and oil industries, also attest to the fundamental character of, the general concern respecting and the extreme seriousness of the far-reaching and basic questions and principles, among others, herein at issue, to-wit: the Commission-asserted jurisdiction over production and gathering; the Commission refusal under its "cost" theories to consider the "value" of natural gas and natural gas reserves; and the judicial denial of any real right of actual review.

It is true *as a matter of law* that "a denial of certiorari by this Court imports no expression of opinion upon the merits of a case" *(House v. Mayo,* 324 U.S. 42, 48, 65 S.Ct. 517, 521), and so settles and determines no questions, issues or principles whatever. It is also true *as a matter of fact* that the improper, arbitrary and illegal procedures, actions and determinations of fact, of law and of jurisdiction indulged by an administrative agency or by a court of appeals, upon such denial, automatically become clothed with a *de facto* propriety and validity.

The practical result of denial of the writ in this case is simply to aggravate the legal uncertainty and doubt heretofore and now existing; to postpone without day the resolution of the several questions presented, with respect to which this Court as yet has made no authoritative or any

5. See briefs therein of Natural Gas Industry Committee, American Petroleum Institute, Independent Natural Gas Association of America, Independent Petroleum Association, Texas Mid-Continent Oil & Gas Association, and many others.

determination; to lend the color of propriety to the refusal of the court of appeals to perform its mandated duty of review *(Pet. for Cert., p. 4)*; and to sanction the grievous and irreparable injury inflicted upon petitioner.

The overt state of affairs now existing which justifies and requires judicial consideration and "re-view," is summarized as follows:

I.

The present status of the question of jurisdiction of the Power Commission over "the production or gathering of natural gas" is:

1. The Gas Act *(Section (1)b)* provides "*The provisions of this Act* * * * shall not apply * * * to the production or gathering of natural gas."

2. The Power Commission, herein, without comment or explanation, incorporated the production and gathering facilities including the natural gas leaseholds and reserves of petitioner, in the over-all utility rate base, and in the so-called rate base of the regulated business.

3. The Court of Appeals herein held that Commission jurisdiction over production and gathering had been "squarely met and conclusively decided" by this Court in the *Canadian River Gas Company* case, *supra (R. V. 3, p. 1328)*.

4. This Court disposed of the *Canadian River Gas Company* case, *supra*, by three divergent opinions in which the alignment of the Court was five to four that the Commission does not have jurisdiction over "any direct regulation of that activity" *(See Pet. for Cert. Supporting Brief, pp. 47-49)*. The same opinions, on the basis of eight to one, recognized that "reflecting the production and gathering facilities in the rate base" in fact was the exercise of direct regulation of that activity.[6]

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6. See Southern Pacific Co. v. Interstate Commerce Comm., 219 U.S. 433, 31 S.Ct. 288, 290-291. In that case this Court quickly disposed of the fiction that by labelling the act of regulation as something else and less, it ceased to be regulation. Chief Justice White, speaking for the entire Court, brushed aside the Commission contention that it had "simply taken into consideration," as here claimed, "some of the elements proper to be considered in

5. If any "authoritative determination" of "the principles of law involved" was made through "agreement by a majority of the Court" in that case, it was that the Commission does not possess the jurisdiction of "direct regulation over that activity" and that "reflecting the production and gathering facilities in the rate base" was the exercise of direct regulation. Otherwise "the lack of an agreement by a majority of the Court * * * prevents it (the decision in the *Canadian* case) from being an authoritative determination for other cases."

6. It is evident, therefore, that the Court of Appeals "acted under a misapprehension as to the meaning of the statute," and the decision of this Court in the *Canadian River Gas Company* case, *supra*.[7]

II.

The Commission insistence upon "cost," and its refusal to consider the "value" of natural gas as a commodity and of natural gas reserves, involve the following:

1. The Commission, in approving the refusal of its trial examiner to receive any evidence of "value" of gas reserves, did so on the ground that *Section 6(a)* of the Gas Act required such exclusion *as a matter of law*. The Commission's contention in that behalf as stated is: "Our view as to why such evidence should be excluded has been stated in earlier opinions" *(R. V. 1, p. 31; Reply Br. Pet. for Cert., pp. 5-9)*.

2. Such exclusion, in this case, operated in 1941 to require petitioner *to give away without any compensation whatever*, aside from certain of the actual expenses of production, about two-thirds of its own total production of natural gas. Such production, in 1941, was 43,150,770 M.c.f. *(R. V. 3, p. 1343)*.

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the ultimate exertion of the lawful power to forbid an unjust and unreasonable rate and fix a reasonable one." Thereupon the Court applied the true test, that the nature and character of its order determined the substance of the power which the Commission undertook to exert in making such order.

7. Pet. for Cert. and Supporting Brief, pp. 6, 47-49; Reply Brief, pp. 4-5. See Southern Pac. Co. v. Interstate Commerce Comm., 219 U.S. 433, 31 S.Ct. 288, 290-291.

3. Further, such exclusion, if the Commission order is allowed to stand, will operate to require petitioner, in all years thereafter and hereafter, to continue similarly *to give away* each year even larger amounts of gas than in 1941.

4. This Court, repeatedly and specifically, has declared, contrary to the asserted rule of law upon which the Commission relied here, "that the Commission was not bound to the use of any single formula in determining rates"; and that "the question for the courts when a rate order is challenged is whether the order viewed in its entirety and measured by its end result meets the requirements of the Act," that is, among other things, whether it satisfies the statutory standard of "fair and reasonable." *(Pet. for Cert. and Supporting Brief, pp. 7-9, 49-58; Reply Br. Pet. for Cert., pp. 5-9).*

5. This Court, in the *Canadian River Gas Company* case, *supra,* the one case in which the question was sought to be raised, expressly refused because of "the limited review granted the case," to pass upon the "end result" of "including the production properties in the rate base at actual legitimate cost" *(Pet. for Cert. and Supporting Brief, pp. 7-8, 52; Reply Br. Pet. for Cert., p. 8).*

6. Notwithstanding the misconception of the law by the Commission, the Court of Appeals refused to consider that which this Court described as "the question for the courts." That Court additionally misapprehended the law and the holding of this Court in the *Canadian* case by its stated conclusion that the question had been "specifically treated on appeal" and disposed of in that case.

7. Moreover, there is no support whatever in the law for the impossible burden which the Court of Appeals attempted to impose upon this petitioner and every other utility, to-wit: "We have not the right to intercede unless it is *conclusively shown* that *failure to give consideration to the fair value* of properties, including the valuable leasehold estates, *will prevent the company from operating successfully as a public utility*" *(R. V. 3, p. 1332; Reply Br. Pet. for Cert., pp. 6-7).*

8. Thus as to this issue, the Court of Appeals, as well as the Commission, "has not proceeded under a correct rule

of law" or correct rules of law. This "value" issue, as yet undecided by this Court, certainly by every standard of importance is one of very great "gravity and general concern" to all producers, transporters and consumers of natural gas, as well as to this petitioner *(Connecticut L. & P. Co. v. Federal Power Comm.,* 324 U.S. 515, 65 S.Ct. 749).

III.

In connection with the subject matter "existing depreciation" and the disposition thereof by the Commission and by the Court of Appeals, the situation presented is:

1. The Commission, as required by law, sought *by evidence* to establish *the facts* of "existing depreciation," and therefrom the annual depreciation rates to be used under the "service life" method adopted by the Commission and its staff *(R. V. 1, p. 45).* The Commission evidence thus undertook to lay the foundation for the conclusions contained in the two *essential* and only Commission exhibits on the subject *(Comm. Ex. 15, R. V. 3, pp. 1127-1141,* entitled "Service Lives and Annual Depreciation Rates"; *Comm. Ex. 12, R. V. 3, pp. 1039, 1042,* entitled "Annual and Accrued Depreciation"). *Exhibit 15* purported to contain a factual determination of both the physical and functional elements of depreciation *(R. V. 1, pp. 427, 430; R. V. 3, pp. 1127-1128).* The Commission depreciation engineer *(R. V. 1, p. 72),* who prepared *Exhibit 15* and presented it in evidence, is the "qualified staff engineer" who the Commission found "inspected the Company's properties" and who, based on his first hand knowledge, "treated realistically both the physical and functional aspects of depreciation" *(R. V. 1, p. 44).*

2. But this witness testified specifically that he never inspected a single length of pipe in petitioner's 4300 mile pipeline system, which constituted 70% of its entire constructed plant, according to the Commission *(R. V. 1, pp. 450-451; Op. of Ct., R. V. 3, pp. 1334-1335; Comm. Ex. 5, pp. 977-978; R. V. 1, p. 50).*

3. The foregoing finding of the Commission *(R. V. 1, p. 44)* clearly was foundational to the permissible introduction of *Exhibits 15 and 12* in evidence. The finding, how-

ever, was not supported by but contrary to the uncontroverted facts. In short, it was not true.

4. The Court of Appeals, fully aware of this failure of proof, was unable to acquiesce in the Commission's distortion of the record. Accordingly, that Court made its own finding, in substitution for the discredited Commission finding wherein it sought to excuse such failure of proof and the unsupported finding *(R. V. 3, pp. 1334-1335)*.

5. The patent result is that the Commission did not meet the burden specifically imposed upon it by *Section 19(b)* of the Gas Act; and the Court of Appeals made findings and substituted them for those of the Commission, which it is not authorized by law to do *(Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U.S. 626, 634, 65 S.Ct. 850, 854)*. The applicable law as declared by this Court is clear.

IV.

The Commission-determined alleged "excess profits" of Cities Service *Oil* Company under contract with this petitioner, Cities Service *Gas* Company, for the extraction of natural gas gasoline from a portion of the gas produced and purchased by petitioner, were "credited" to "the operating expenses" of this petitioner under the following circumstances:

1. The affiliate relationship between petitioner and the *Oil* Company admittedly and properly is subject to Commission and judicial inquiry to insure that the contractual relation in question be reasonable and equivalent to "arm's length dealing" *(Pet. for Cert. and Supporting Brief, pp. 11-13, 62-66; Reply Brief, pp. 12-13)*.

2. The Commission, it is conceded, made no attempt whatever to make such inquiry into or determine the reasonableness of the transaction in question on the basis of "arm's length dealings" *(R. V. 2, pp. 798, 802)*. The petitioner does not have and never has had any title or interest whatever in the extraction plants and operations of the *Oil* Company *(R. V. 3, pp. 1033, 1037)*. The Commission *admittedly* treated the extraction plants, business and earnings of the *Oil* Company "as if they belonged to petitioner"

(Op. of Ct., R. V. 3, pp. 1335-1337; R. V. 1, pp. 53-55; R. V. 2 pp. 792, 802). It set up a "cost" rate base for the *Oil* Company plants and *allowed* that Company 6½% return thereon (after allowance of certain expenses but not including Federal income taxes) *(R. V. 1, p. 54; R. V. 2, pp. 805, 806; R. V. 3, p. 1021).* All earnings of the *Oil* Company, which is not a "natural gas company" under the Gas Act, in excess of the purported "return at 6½% on rate base," averaged for the years 1939-1941, were declared to be "excess earnings" *(R. V. 2, p. 800)* and "credited" as above stated to "the operating expenses" of this petitioner *(R. V. 1, pp. 53-55).* This amounted to seven-eighths of all such earnings, including earnings upon such extraction from natural gas which went into the non-regulable sales of petitioner in addition to its regulated sales *(R. V. 1, pp. 53-55).*

3. The two natural gasoline extraction plants in question were from 150 to in excess of 250 miles, respectively, from the fields of production of the gas processed. Enroute most of the gas passed through five compressor stations *(Map, Comm. Ex. 14, Sch. 1, R. V. 3, p. 1119; R. V. 2, pp. 775, 776).* These blunt uncontroverted facts improperly were ignored by the Court of Appeals *(Connecticut L. & P. Co. v. Federal Power Comm., supra).*

4. The "findings" of that Court were an attempt, by an inaccurate recital of the direct testimony of the Commission "staff witness," to justify the Commission action here, under "the theory" of *Cleveland v. Hope Natural Gas Company,* 44 P.U.R. (n.s.) 1, 27-28, where there were specific findings supported by the evidence that "the extraction of gasoline and butane * * * is necessary to make the natural gas marketable and transportable."[8] The Commission added,

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8. Even if, contrary to the facts of this case, the extraction of natural gas gasoline were necessary to make the natural gas marketable and transportable, the established principles of law controlling the dealings between affiliates would not thereby be altered or repudiated. This argument of "necessity" upon which the Commission and Court of Appeals rely would apply equally and without limit to extend the jurisdiction of the Commission, contrary to the direct statutory limitations, to other non-regulated activities, conceived by the Commission to be physically, economically or otherwise "essential" or "necessary" to the "natural gas company" business and operations.

"It is significant that Hope Natural Gas Company processed its own gas before 1920." Neither before the Commission nor on review *(Hope Natural Gas Co. v. Federal Power Comm.,* 134 Fed. (2d) 287, 307) did the company there involved raise any issue as to the propriety of such Commission action.

5. The result, on the facts and under controlling law, appears arbitrary and illegal. The Commission and Court of Appeals alike ignored the established principle of law declared and enforced by this Court, that the *Oil* Company "is to be treated as a segregated enterprise" even though the affiliate relation "may demand close scrutiny" *(Smith v. Illinois Bell Tel. Co.,* 282 U.S. 133, 144, 151-153, 51 S.Ct. 65, 67, 70; *United Fuel Gas Co. v. Commission,* 278 U.S. 300, 321, 49 S.Ct. 150, 156; *Canadian River Gas Co. v. Federal Power Comm.,* 324 U.S. 581, 615-625, 65 S.Ct. 829, 845-850; *Southern Pacific Co. v. Interstate Commerce Comm.,* 219 U.S. 433, 31 S.Ct. 288, 290-291). In the case last cited, Chief Justice White, dealing with an analogous situation, exploded the present Commission assertion *(Comm. Br. p. 17)* that the expropriation in this case of the gasoline extraction plants and business of the *Oil* Company was merely the "use of data" and did not constitute "regulation of the gasoline extraction business" of that Company, which admittedly is beyond Commission jurisdiction.

The Court of Appeals additionally undertook to make findings of its own to support and give the mark of validity to the Commission action. This, of course, it had no authority to do *(Colorado-Wyoming Gas Co. v. Federal Power Comm., supra).*

V.

The elimination and exclusion by the Commission of *all* "Federal income taxes," an item of actual operating expense, from the Commission total "cost of service" *(R. V. 1, pp. 57-58)* and thereafter from its so-called "cost of service allocation" *(R. V. 1, p. 61)*, presents the following considerations:

1. The Commission, in making such elimination and exclusion, proceeded *on the legal theory* that all earnings of

petitioner upon the supposed non-regulable business, in excess of 6½%, on whatever undisclosed portion of the *overall* "rate base of $48,567,756" *(R. V. 1, pp. 50-58)* covering all properties and operations, which the Commission assumed to assign to such non-regulable operations, are "excess earnings" and, therefore, illegal *(R. V. 3, p. 1337; R. V. 1, p. 58)*.[9]

2. The Commission, in making such elimination and exclusion, proceeded *on the factual assumption* that, in its determination of Federal income taxes, *all* usual and ordinary expenses of *the entire business* and all other lawful tax deductions *in full* could be utilized *as was done in this case,* for the sole benefit of petitioner's earnings up to 6½% on the non-regulable as well as the regulable business. The purpose and effect of this improper procedure was to produce a mathematical and accounting result, which on its face would purport to show no Federal income tax on a return of "6½% on the over-all rate base," and thus "assign all Federal income tax liability • • • to non-regulable sales" *(R. V. 3, p. 1337)*. The evident fact is that *such* Federal income tax liability could be ascertained only by a proper segregation of expenses and other deductions, as well as of revenue, between the 6½% over-all return and the return on the non-regulable business in excess of 6½%. There is nothing of the kind in the record *(Pet. for Cert. Reply Brief, pp. 15-17)*.

3. The factual assumption, which strains logic to absurd extremes, is unfair and unreasonable. The legal theory is arbitrary and illegal *(Galveston Electric Co. v. Galveston,* 258 U.S. 388, 42 S.Ct. 351; *Vinson v. Washington Gas Light Co.,* 321 U.S. 489, 502-503, 64 S.Ct. 731, 737, dissenting opinion Mr. Justice Douglas).

4. The Commission procedure here under discussion indicates with clarity the stern necessity for judicial supervision and correction. This duty the Court of Appeals re-

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9. See, to the contrary, Panhandle Eastern Pipe Line Company case, supra, 324 U.S. at pages 641-642, 65 S. Ct. at page 825; Colorado Interstate Gas Company case, supra, 324 U.S. at pages 586-589, 65 S.Ct. at pages 832-833.

fused to perform. First, it reiterated and adopted the erroneous legal theory of the Commission. Second, in the factual premise indulged by it, to-wit: "If, as the Commission found, there would be no Federal income tax liability under the 1941 rates on a permissible return from the adopted rate base" *(R. V. 3, p. 1337)*, that Court overlooked completely the fact *that on this record* no such determination was made or could be made. Thus, that Court proceeded under a misconception of the law as well as a misapprehension of the entire absence of essential evidence to support the Commission's factual assumptions *(Pet. for Cert. and Supporting Brief, pp. 13-16, 34-35, 66-68; Reply Br., pp. 15-17)*.

VI.

"The necessity" for the separation of the regulated and unregulated "facilities and operations" of petitioner to insure that no part of the unregulated business "be assigned to the regulated business" which "would transgress the jurisdictional lines which Congress wrote into the Act" *(Panhandle Eastern Pipe Line Co. v. Federal Power Comm., supra)*, presents in this record serious problems of law and fact:

1. The Commission made no such actual separation. It did indulge what it described as an "allocation of cost of service." Such procedure this Court in general has approved. However, nothing in this record, or in the opinion of the Commission, discloses compliance with the governing standards of jurisdiction, judgment and fairness laid down by this Court in the *Panhandle Eastern Pipe Line Company* and *Canadian River Gas Company* cases, *supra (Pet. for Cert., Supporting Brief, pp. 68-75; Reply Brief, pp. 17-19)*.

2. The Court of Appeals was insensitive to its judicial function of review and flatly refused to examine, consider or review at all any part of the Commission so-called allocation procedures and results, on the assigned reason "We shall not criticize that which we are powerless to correct," although at the same time expressly recognizing that "some

of the specific allocations appear to be illogical and unfair" *(R. V. 3, p. 1339)*.

3. This action of the Court of Appeals is contrary to the express declarations and actual procedures of this Court in the cases above referred to and in *Colorado-Wyoming Gas Co. v. Federal Power Comm., supra.* The right to and duty of judicial review embraces questions of allocation even though they "pose technological problems of accounting and finance" *(R. V. 3, p. 1339)*.

It is not the law that courts are excused from the performance of their judicial functions of mandated review because the issue involves technical or technological problems or because of any other extraneous considerations *(Pet. for Cert., pp. 16-19; Supporting Brief, pp. 68-75; Reply Brief, pp. 17-19)*.

CONCLUSION.

The Court of Appeals did not undertake to define and execute its own functions and duties as the court of review, but by its repeated assertions and conclusions as to the finality of the administrative process disclosed a philosophy wholly at variance with any real or effective judicial supervision and review whatever *(R. V. 3, pp. 1327, 1328, 1332, 1339; Pet. for Cert., p. 4)*.

Judicial review is "more than an abstract ideal." It is not mere theory. It is a practical concept and "has proved its efficiency." It is not to be dispensed or withheld at will. The "discretion" involved is otherwise directed and governed.

Judicial review "is a way of life worked out by human hands and brains" from the very inception of the Republic, as a necessary, salutary and foundational principle of action to preserve and protect rights; to enforce the performance of duties; and to confine the activities of agencies of government within the prescribed limits and manner of exercise of their respective functions.

Important principles, serious issues and numerous probable or certain errors are not settled, are not resolved and are not corrected, by the silence of a formal refusal to consider them. However heavy the burdens of judicial administration may be, the fact still remains that the substance and spirit of the judicial function cannot be realized merely by adherence to and performance of the formality of procedures.

Respectfully submitted,

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CERTIFICATE OF COUNSEL.

Donald C. McCreery, one of counsel for Petitioner, hereby certifies that the above and foregoing Petition for Rehearing is presented in good faith and not for delay.

Dated at Denver, Colorado, this 2nd day of December, 1946.

DONALD C. MCCREERY.